95-909

No.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AGAINST POWERINE OIL COMPANY, DEBTOR IN BANKRUPTCY,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In determining for purposes of § 547(b)(5) of the Bankruptcy Code whether a transfer enabled a creditor to receive more than such a creditor would have received in a liquidation of the transferor's assets under chapter 7 of the Code, must a court disregard the fact that the transferee was the beneficiary of an irrevocable standby letter of credit issued by the transferor's bank which the transferee would have drawn down in the amount of the transfer had the transfer not occurred?

2. Is it an essential element of a voidable preferential transfer under the Bankruptcy Code that the transfer diminished the amount claimants in the same class as that of the transferee would have received had the transfer not been made?

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

Petitioner Koch Oil Company has no parent company, subsidiaries or affiliates that have issued shares to the public.

According to a Disclosure Statement filed by Powerine Oil Company in the U.S. Bankruptcy Court for the Central District of California on December 10, 1984, the Respondent Committee of Creditors Holding Unsecured Claims consisted of representatives of the following individuals and entities: Ofcco Construction Co.; Macco Contractors, Inc.; San Diego Pipeline Co.; Crosby & Overton, Inc.; Rau & Rice Enterprises, Inc.; 415 Mid-Continent Tower; Southern Pacific Pipeline Inc.; Peter L. Lacombe; Charles R. Tatum; American Instrument; Union Oil Co. of California, and Kilpatrick, Clayton, Myer & Madden.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Koch Oil Company respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in the above captioned case on July 12, 1995.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 59 F.3d 969, 27 Bankr. Ct. Dec. 623, Bankr. L. Rep. p. 76,554 and is reprinted in the appendix hereto ("App.") at A1. The decision of the United States Bankruptcy Appellate Panel for the Ninth Circuit is not reported and

is reprinted at App. B1. The Memorandum of Decision of the United States Bankruptcy Court for the Central District of California is not reported and is reprinted at App. C1. The Findings of Fact and Conclusions of Law adopted by the Bankruptcy Court are not reported and are reprinted at App. D1. The Summary Judgment of the Bankruptcy Court is not reported and is reprinted at App. E1.

JURISDICTION

The Court of Appeals filed its opinion on July 12, 1995. App. A1. That Court denied a timely filed petition for rehearing on September 7, 1995. App. F1. The jurisdiction of this Court rests on 28 U.S.C. § 1254.

PERTINENT STATUTORY PROVISIONS

Pertinent provisions of the Bankruptcy Code of 1978, as amended (11 U.S.C. §§ 101-1330), are set forth at App. G1.

STATEMENT OF THE CASE

In the Ninth Circuit, there are times when a trade creditor can count itself lucky if its customers don't pay their bills. The petitioner in this case, Koch Oil Company, had the dubious honor of being the first to find this out when its customer Powerine Oil Company filed for bankruptcy shortly after paying for 155 thousand barrels of crude oil Koch had delivered to it in preceding weeks.

At various times during the period 1982-1984, Koch entered into contracts to sell crude oil to Powerine (App. D2-D3). Under these contracts, Powerine was to pay Koch for the crude oil on the twentieth day of the month following the month of delivery. (Defendant's Statement of Uncontroverted Facts filed in he Bankruptcy Court on August 1, 1989 [hereinafter cited as "Uncontroverted Facts"]). At Koch's insistence, Powerine secured its obligation to pay Koch by directing the First National Bank of Chicago ("FNBC") to issue two irrevocable standby letters of credit for its account in favor of Koch as beneficiary (Uncontroverted Facts, ¶ 1). The first of these letters of credit was issued on December 27, 1982. Addressed to Koch "by the order of Powerine Oil Co.", it stated:

> We hereby issue in your favor our irrevocable credit for the account of Powerine Oil Co. for an amount or amounts not to exceed in the aggregate US Dollars 3,596,000.00 (Three Million Five Hundred Ninety Six Thousand and No/100 US Dollars) available by your drafts on The First National Bank of Chicago, Chicago, IL, U.S.A. effective December 27, 1982 and expiring at our office on February 28, 1983.

(Uncontroverted Facts, ¶ 1, Gr. Ex. 1).

This letter of credit subsequently was amended at various times at Powerine's request to extend the expiration date of the letter or the amount of the letter. As finally amended, the expiration date was April 30, 1984 and the amount was $7,074,620. (Uncontroverted Facts, ¶ 1, Gr. Ex. 1). The second letter of credit was issued on July 20, 1983 in essentially the same form. It advised Koch that:

> We hereby issue in your favor our irrevocable credit for the account of Powerine Oil Co. for an amount or

> amounts not to exceed in the aggregate US Dollars 837,000.00 (Eight Hundred Thirty Seven Thousand and No/100 US Dollars) available by your drafts at sight on The First National Bank of Chicago, Chicago, IL. U.S.A. effective July 20, 1983 and expiring at our office on September 30, 1983.

(Uncontroverted Facts, ¶ 1, Gr. Ex. 1). The second letter of credit also subsequently was amended to change its expiration date to April 30, 1984 and its amount to $1,674,000. (*Id.*).

If Powerine failed to make timely payment, Koch could collect the amount of the payments from the FNBC by presenting to the bank, prior to the expiration date of the letters of credit, the commercial invoices for the product delivered and a statement certifying that the invoices were unpaid as of their due dates and that Koch held legal title to the crude oil prior to transferring such title to Powerine. (Uncontroverted Facts, ¶ 1, Gr. Ex. 1).

As consideration for issuing the letters of credit, the FNBC required Powerine to enter into security agreements for the benefit of the bank. The first of these agreements provided, in pertinent part, that Powerine would reimburse the bank at its demand for any amount the bank paid on drafts or drawings, or pay the bank in advance any amount required to pay such drafts or drawings; that "each amount which may become due and payable to you under this Agreement may, in your discretion, and if not otherwise paid, be charged by you to any available funds then held by you for our account," and that:

> all property . . . in which any of us may have an interest, of every name and nature whatsoever, now or at any time hereafter delivered, conveyed, trans-

> ferred, assigned, or paid to you, or coming into your possession in any manner whatsoever, whether expressly as security for any of our obligations or liabilities to you, or for safekeeping or otherwise, including any items received for collection or transmission and the proceeds thereof, whether or not such property is in whole or in part released to us on security agreement, is hereby made security for each and all such obligations and liabilities.

(Uncontroverted Facts, ¶ 2, Gr. Ex. 1). The wording of the agreement securing the second letter of credit was essentially the same. (*Id.*).

These were not the only security agreements Powerine had entered into with the FNBC. Some 20 months before issuance of the first letter of credit, Powerine had entered into an agreement with a trust organized for the benefit of a syndicate of several insurance companies and banking institutions, including the FNBC, to secure a $250.6 million line of credit. Under this agreement, Powerine assigned the trustee a security interest in most of its personal property:

> . . . for the purpose of securing equally without preference or priority of any one over the other:
>
> A. Payment of the indebtedness evidenced by the Bank Notes and the Insurance Company Notes (collectively, the "Notes");
>
> B. Payment of obligations of Debtor to any one or more of the Banks under applications for letters of credit under which letters of credit have been, or are in the future, issued on the account of Debtor in favor of vendors of crude oil sold to Debtor.

(Uncontroverted Facts, Ex. 2).

Prior to March of 1984, Powerine had always made timely payment, including two payments—each for more than $4 million, that fell due within the 90 days preceding the filing of Powerine's chapter 11 bankruptcy petition on March 26, 1984).[1] Powerine made these two payments by instructing the FNBC to make wire transfers from Powerine's checking account to Koch's account at the FNBC. (App. D4) To permit the transfers, the FNBC released its security interest in the funds in the checking account (App. D4; Uncontroverted Facts, ¶ 4).

The two letters of credit expired by their terms on April 30, 1984. On March 25, 1986, Respondent Committee of Creditors Holding Unsecured Claims commenced an adversary proceeding against Koch seeking to set aside the two payments Powerine made to Koch within the 90 days preceding bankruptcy as preferences under Bankruptcy Code § 547(b).[2] (App. A5; Complaint ¶¶ 5-11). It was undisputed that if Powerine had not paid, Koch would have been paid in full by the letters of credit.

The Bankruptcy Court rejected Respondent's claim on the ground that, because the FNBC permitted the payments to be made out of a Powerine checking account in which the bank held a security interest, the payments fell within the Code § 547(c)(1) exception for transfers

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[1] Powerine failed to make a payment of over $4 million due in the same month it filed its petition and Koch drew down the letters of credit in a corresponding amount. The FNBC then debited Powerine's checking account in that amount pursuant to its rights under the agreements securing the letters of credit. (App. B3-B4).

[2] Respondent initially contended that the entire $8,550,990.70 paid was preferential but subsequently acknowledged that over $5 million of that amount was insulated by the "ordinary course of business" defense of Code § 547(c)(2).

that were contemporaneous exchanges for new value. (App. C2).

The Bankruptcy Appellate Panel disagreed with the Bankruptcy Court's analysis to a certain extent. Observing that the debtor's obligation to reimburse FNBC in the event the bank paid on the letters of credit was undersecured, the BAP concluded that the § 547(c)(1) exception to avoidability only protected the transfers in an amount equal to the amount of the released checking account funds that represented security for the bank's obligations on the letters of credit. (App. B9-B10).

The BAP went on to hold, however, that the portion of the payments with respect to which the Bank's letter of credit obligations was unsecured did not constitute a preference because it did not satisfy the requirement of Code § 547(b)(5) that the transfer enable the creditor to receive more than it would receive if the transfer had not taken place and the debtor's estate was liquidated under chapter 7 of the Code. (App. B12). Koch did not receive more than it would have received, the BAP reasoned, because if Powerine had not paid, Koch would have drawn down the letters of credit. Noting that "avoidance of a preferential transfer is purposed upon placing the estate and its creditors in the same position they would occupy had no transfer been made" (App. B15), the BAP concluded that disregarding the fact that Koch would have drawn down the letters of credit had Powerine not paid would frustrate the intent of the preference provisions of the Code and was not required by the language of the statute.

The Court of Appeals reversed, ruling that in making the comparison with an hypothetical chapter 7 distribution required by § 547(b)(5), the statutory language pro-

vided no basis for taking into consideration Koch's right to draw on letters of credit in deciding whether Koch received a preference. (App. A9). Although the Court of Appeals viewed the BAP's decision as an attempt to exercise equitable power to avoid an unjust result, it stated that equity may not be invoked to defeat clear statutory language nor to reach results inconsistent with the statutory scheme established by the Code. (App. A8). Treating Koch as an unsecured creditor of Powerine, the Court of Appeals concluded that, since it was evident that unsecured creditors would not have received 100 cents on the dollar in a chapter 7 liquidation, the transfers to Koch met the test of § 547(b)(5). (App. A7).[3]

REASONS FOR GRANTING THE WRIT

I.

The Court of Appeals incorrectly interpreted and incorrectly applied Bankruptcy Code § 547(b)(5) in this case. Both the Court of Appeals and the Bankruptcy Appellate Panel struggled in interpreting § 547(b)(5) and ended up reaching opposite conclusions through differing analyses. Neither court's ruling was unanimous, and the Court of Appeals' majority opinion seemed to recognize that its ruling was contrary to common sense when it observed that "[l]aw can be stranger than fiction in the Preference

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[3] The Court of Appeals agreed with the BAP that, since the FNBC was undersecured, only the secured portion of its contingent reimbursement claim against the estate was released by Powerine's payment and only to that extent was the transfer to Koch protected by the contemporaneous exchange for new value rule of Code § 547(c)(1). (App. A10). The Court remanded the case to the Bankruptcy Court for determination of what portion of the debt was secured. (App. A11).

Zone." (App. A4). The new meaning given the Code by the Court of Appeals will effectively destroy the commercial usefulness of standby letters of credit and extend the scope of the preferential transfer rules of the Bankruptcy Code to encompass transactions not heretofore considered "preferential".

Although the Court of Appeals acknowledged it must be guided by "clear statutory language" and must reach a result consistent "with the statutory scheme established by the Code," (App. A9), its opinion violated these precepts. The court's prescription for how to determine whether a payment of a debt secured by standby letters of credit meets the test of § 547(b)(5) flies in the face of the intent of the preference provisions of the Code because it ignores the requirement that to be preferential a transfer must result in a diminution of the bankrupt's estate. Thus, the Court of Appeals engaged in a form of statutory construction often cautioned against by this Court.[4]

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[4] It is axiomatic that the parts of a statute are to be interpreted in the context of the meaning and policy objectives of the entire legislative expression. A statute is passed as a whole and is animated by one general purpose and intent. Courts will not only consider the particular provision in question, but the entire legislative scheme. *See Kelly v. Robinson*, 479 U.S. 36, 43 (1986), citing *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 222 (1986). *See, also, Tigr Restaurant, Inc. v. Rouse S.I. Shopping Center, Inc.*, 79 B.R. 954 (E.D. N.Y. 1987); *In re Sokolsky*, 18 B.R. 138 (M.D. Fla. 1982). The Bankruptcy Code should not be interpreted to erode past bankruptcy principles absent an indication of clear congressional intent to do so. *Dewsnup v. Timm*, 502 U.S. 410 (1992); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990); *In re Bonner Mall Partnership*, 2 F.3d 899, 913 (9th Cir. 1993).

The *sine qua non* of a voidable preference is that the transfer alleged to be preferential resulted in a diminution of the bankrupt's estate. *If the transfer did not reduce the amount that creditors otherwise would have received, there is no preference.* Diminution of the bankrupt estate is an "essential element of a preferential transfer within the meaning of the Bankruptcy Act". *Continental & Commercial Trust & Savings Bank v. Chicago Title & Trust Co.*, 229 U.S. 435, 444 (1913).

> To constitute a preferential transfer within the meaning of the Bankruptcy Act there must be a parting with the bankrupt's property for the benefit of the creditor *and a consequent diminution of the bankrupt's estate. New York County National Bank v. Massey,* 192 U.S. 138, 147; *Newport Bank v. Herkimer Bank*, 225 U.S. 178, 184.

Id. at 443 (emphasis added). After concluding in the *Continental & Commercial Trust* case that the essential element of diminution was missing from the transaction, this Court noted:

> The fact that what was done worked to the benefit of the creditor and in a sense gave him a preference is not enough, unless the estate of the bankrupt was thereby diminished.

Id. at 444.

Congress has not departed from that fundamental principle in the years since this ruling. The measure of the value of a voidable preference continues to be diminution of the debtor's estate, not the value of the transfer to the creditor. *See Virginia Nat. Bank v. Woodson*, 329 F.2d 836, 840 (4th Cir. 1964) ("The test is not what the creditor receives, but what the bankrupt's estate has lost. It is the diminution of the bankrupt's estate, not the unequal payment to creditors, which is the evil sought to be

remedied by the avoidance of a preferential transfer."); *Palmer v. Radio Corp. of America*, 453 F.2d 1133, 1135 (5th Cir. 1971) ("Even though not expressly provided by [the Bankruptcy Act] it is implicit from the language used that the transfer must result in a diminution of the bankrupt estate."); *In re Metro Communications, Inc.* 115 B.R. 849, 856 (W.D. Pa. 1990). *Cf. Gillman v. Chase Manhattan Bank,* 537 N.Y.S.2d 787, 795-96 (Ct.App. 1988). *See, also, In re Kemp Pacific Fisheries, Inc.*, 16 F.3d 313 (9th Cir. 1994); *Pine Top Insurance Co. v. Bank of America Nat'l Tr. & Sav. Ass'n,* 969 F.2d 321, 329 (7th Cir. 1992); *In re California Trade Technical Schools, Inc.*, 923 F.2d 641, 645 (9th Cir. 1991); *Matter of Holiday Airlines Corp.*, 647 F.2d 977 (9th Cir. 1981); *Matter of Southmark Corp.*, 49 F.3d 1111 (5th Cir. 1995); *In re Interior Wood Products Co.*, 986 F.2d 228 (8th Cir. 1993); *In re Montgomery*, 983 F.2d 1389 (6th Cir. 1993); *Matter of Compton Corp.*, 831 F.2d 586, 593 (5th Cir. 1987); *Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750 (11th Cir. 1983). *Cf. In re E.R. Fegert, Inc.*, 887 F.2d 955, 959 (9th Cir. 1989); *Matter of Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224, 227-228 (5th Cir. 1988). *But see In re Bergner,* 1995 WL 566128 (Bankr. E.D. Wis) *6-*7 (venturing an opinion that, for purposes of preference analysis, "transfer" and "diminution" are correlative concepts).

The Court of Appeals made no effort to determine whether this essential element of a preference was present in the case of the Powerine/Koch transfers, apparently assuming that diminution invariably occurs in the case of transfers to unsecured creditors of an insolvent debtor. The arbitrary result of this decision, the first to interpret the Code in this particular respect, is doomed to be repeated by any court that embraces the Court of Appeal's reading of § 547(b)(5).

Code § 547(b)(5) provides that, except as provided in subsection (c) of the section, a trustee "may avoid any transfer of interest of the debtor in property" that enables a creditor to receive more than such creditor would receive if: the case were a case under chapter 7 of the Code, "the transfer had not been made" and "such creditor received payment of such debt to the extent provided by the provisions of this title." This test requires determination of how much the members of the transferee's class (in this case, the unsecured creditors) would have received on their claims had the transfer not been made. COLLIER ON BANKRUPTCY ¶ 547.08, at p. 547-45 (15th Ed. 1995). To properly apply § 547(b)(5), therefore, a court must determine whether the transfer alleged to be preferential reduced the amount an unsecured creditor would have received in a hypothetical chapter 7 liquidation under a hypothetical alternative set of facts.[5]

In the § 547(b)(5) "alternative reality" of this case, Koch would have drawn down the letters of credit when Powerine did not pay. To ignore, as the Court of Appeals did, the fact that Koch was the beneficiary of the letters of credit and that Powerine's failure to make the payments would have triggered changes in the secured and unsecured claims against the estate, renders the hypothetical comparison useless insofar as achieving the

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[5] There are three ways in which the amount of an unsecured creditor's distribution could be affected: by *increasing* or *decreasing* the total assets of the estate; by increasing or decreasing the *number* of unsecured claims against the estate; by increasing or decreasing the *amount* of some of the unsecured claims. The effect of a change in any one of these variables cannot be assumed unless the others remain constant. Therefore, a valid hypothetical comparison necessarily requires accounting for each of these variables.

equitable distribution goals of the bankruptcy laws is concerned.

To accurately hypothesize the consequences of the chain of events that would have been set in motion by Powerine's failure to pay, it was necessary for the Court of Appeals to identify the bundle of rights and liabilities defining the tripartite letter of credit relationship between Koch, FCNB and Powerine. The Court made no effort to do that in this case. Had the Court done so, it would have been compelled to take into account the fact that ownership interests in the funds used to pay Koch were transferred to the bank and Koch prior to the payments, in transactions that were not voidable under § 547.[6]

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[6] In the bankruptcy law context, these transfers occurred at the time Powerine granted security interests in its property to secure the letters of credit. When a standby letter of credit is issued, two transfers of the debtor's property occur. The debtor's pledge of its assets to secure the letter of credit is a direct transfer of the debtor's property to the bank and an indirect transfer to the beneficiary of the letters of credit. *In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293, 296 (11th Cir. 1988); *Matter of Compton Corp.*, 831 F.2d 586, 590-591 (5th Cir. 1987). *In re Page*, 18 B.R. 713, 716 (D.C. 1982); *Matter of Planes, Inc.*, 29 B.R. 370 (N.D. Ga. 1983). From the moment a letter of credit is issued, the issuing bank has a present claim against the debtor for reimbursement, contingent upon the bank actually paying the beneficiary pursuant to a draw down. This claim becomes fixed upon occurrence of the contingency. *In re Briggs Transp. Co.*, 37 B.R. 76, 79 (D. Minn. 1984).

Each of these transfers is a contemporaneous exchange for new value. In exchange for the transfer to the issuing bank, the debtor received the bank's promise to pay on the letter of credit; in exchange for the transfer to the beneficiary, the debtor received the extension of credit by the beneficiary. *See Matter of Compton Corp., supra*, at 595. In the instant case,

(continued...)

Contrary to the Court of Appeals' opinion, a pre-petition payment by an insolvent debtor of an unsecured debt does not invariably result in a reduction of the amount the other unsecured creditors would receive in a chapter 7 liquidation of the debtor's estate. There are cases where the nature of the transfer itself precludes a finding of such preferential effect. *See* NORTON BANKRUPTCY LAW AND PRACTICE 2d, § 57:9 pp. 57-40 to 57-41 (1994).

The Court of Appeals failed to recognize Powerine's payments to Koch were such "transfers". The beneficiary of a letter of credit, although an unsecured creditor, differs in a crucial respect from an ordinary general creditor, in that the beneficiary bargained for special treatment before the 90-day preference period, just as a party that secures its debt does.

> [U]nder a letter of credit, the beneficiary is ultimately paid regardless of the actions of the debtor. If the debtor defaults the beneficiary is paid through the letter of credit. If not, the beneficiary is paid in the ordinary course of the underlying commercial transaction. The debtor can choose how the creditor is paid, but it cannot determine whether it is paid. Thus, no act of the debtor during the ninety-day

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[6] (...continued)

the dates of such transfers were May 29, 1981, December 27, 1982, and July 12, 1983. (May 29, 1981 was the effective date of the security agreement Powerine entered in favor of the syndicate of banks and insurance companies described, *ante,* at p. 5. Such security arrangements for future advances are valid. *In re Page*, 18 B.R. 713, 716 (D.C. 1982), citing G. OSBORNE, MORTGAGES, at 178-201 (2d Ed. 1970); GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, at 916-46 (1965)).

> period 'prefers' the beneficiary. Like a secured creditor, it is 'preferred' only because of a binding agreement publicly noted in a financing statement prior to the ninety-day period. Such 'preferences' do not offend the policy of the section 547 of preventing last-minute manipulations by the debtor for the benefit of some creditors at the expense of others.

Baird, *Standby Letters of Credit in Bankruptcy*, 49 U. CHI. L. REV. 130, 151 (1982) (footnotes omitted). Funds that a bank requires a debtor to deposit as a condition of the bank's issuing a standby letter of credit to the debtor's creditor, and which the bank allows the debtor to draw upon to pay the creditor, are much like "earmarked" funds, the transfer of which to a creditor does not deplete the debtor's estate:

> A transfer involving depletion of the debtor's estate implies the movement of current value from the debtor to the creditor. In many cases, although property has exchanged hands, close questions arise as to whether a transfer of the debtor's property has occurred. For example, "earmarked" funds, which are never in the debtor's control but are marked by a third party for payment of a particular creditor, are not the debtor's funds and their transfer would not deplete the debtor's estate.

3 NORTON BANKRUPTCY LAW AND PRACTICE 2d, § 57:4 at pp. 57-16 to 57-17 (1994). (footnotes omitted).[7] In such

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[7] Prior to the 1995 revision of Article 5, the Uniform Commercial Code, Section 5-117, treated such funds as earmarked in the context of bank insolvencies, explaining in the Official Comment on that section:

> A bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. But the resulting liability is not like that to its depositors,

(continued...)

cases, the funds are not any more available to the unsecured creditors prior to the transfer than they are after the transfer. Those are exactly the facts of the Powerine "transfers". Powerine's checking account with the FNBC secured the letters of credit and the bank released the funds from this account for payment of Koch. In effect, funds were being disbursed to Koch from assets of Powerine that had been transferred to the bank and Koch long before—when the secured letters of credit were issued.

If Powerine had not paid when due, Koch could have drawn down the letters of credit in the full amount of the overdue payments with impunity, either before or after Powerine filed its petition.[8] At the time the bank paid Koch pursuant to the letters of credit, the bank's claim against Powerine's estate for the secured portion of the letters of credit would cease to be contingent and the

---

[7] (...continued)

> and the security and indemnity furnished by the customer against it . . . are not like its own investments. . . . The bank's credit is engaged, but it expects to be put in funds by its customer before it makes disbursements, or to be reimbursed immediately afterwards. . . . Only the bank's commission . . . will enter the bank's general assets and join the other backing of its deposit liabilities.

[8] Because an issuing bank's obligation to honor a letter of credit is not estate property. *See In re Air Conditioning, Inc. of Stuart,* 845 F.2d 293 (11th Cir. 1988); *Matter of Compton Corp., supra,* at 589; *In re Metro Communications, Inc.* 115 B.R. 849, 854 (W.D. Pa. 1990); *In re W.L. Mead, Inc.* 42 B.R. 57, 59 (N.D. Oh. 1984); *In Re M.J. Sales & Distributing Co., Inc.*, 25 B.R. 608, 614 (S.D. N.Y. 1982) (relying on *First Nat. Bank v. Phalen*, 62 F.2d 21 (7th Cir. 1932); *In re Zaferis Bros. & Co.*, 67 F.2d 140 (9th Cir. 1933) and *National Bank of Newport v. National Herkimer County Bank of Little Falls*, 225 U.S. 178 (1912)).

bank also would possess an unsecured claim against the estate for the balance of Koch's draw-down. In effect, the bank would be substituted for Koch as an unsecured creditor for the unsecured portion of the letters of credit.[9]

On the other hand, when Powerine paid Koch, the bank's *secured* contingent claim against the estate was extinguished, which reduced the amount of unsecured claims against the estate, *pro tanto*; accordingly, the amount that would have been available for distribution to the unsecured creditors was correspondingly increased. The bank's contingent *unsecured* claim against the estate was also extinguished when Powerine paid Koch, which also increased the estate available for distribution to the creditors represented by Respondent.[10] If there is any doubt that this was a "transfer" to Koch without impact on the unsecured creditors, consider what would have happened if the bank had refused to release its lien on the checking account. Since Powerine possessed no unencumbered funds that it could have used to pay Koch, Powerine would have defaulted, Koch would have drawn down the letters of credit and the bank would have reimbursed itself out of the checking account, just as it did when Powerine defaulted on its March 1984 payment to Koch.

---

[9] Exchanging one unsecured creditor for another does not create any kind of preference. *Matter of Compton Corp.*, *supra*, at 593.

[10] If any preferential diminution of the estate occurred at all as a result of Powerine's payment of Koch, it was as a result of the indirect transfer to the bank that occurred when Powerine paid Koch and thereby extinguished the unsecured portion of the bank's liability to Koch on the letters of credit, which liability would have become an unsecured claim against the estate, had Koch drawn down the letters of credit.

As can be seen from the foregoing, the Court of Appeals focused on the wrong transfers in the wrong time frame and disregarded an essential element of a preference in applying the § 547(b)(5) test in this case. By reversing the transfers to Koch as preferential, the Court of Appeals did not replenish an estate depleted by the transfer, but increased the amount the Respondent group will receive over what they would have received had the transfer not been made—an indefensible windfall to the Respondent Committee at Koch's expense.

II.

With respect to transactions like those between Koch and Powerine, banks commonly require the customer requesting issuance of a letter of credit to provide security for the bank's assuming the contingent obligation to pay the beneficiary. In practice, the arrangement often takes the following form: the bank requires the debtor to deposit funds in the amount of the letter of credit to secure the bank's obligation on the letter. If the buyer doesn't pay the seller and the seller draws down the letter of credit, the bank reimburses itself out of the buyer's deposited funds; if the buyer does pay, the bank releases the deposited funds to cover the payment. DOLAN, THE LAW OF LETTERS OF CREDIT, ¶ 7.05; Appx.A-75 (2d Ed. 1991). That is what happened in the Koch/Powerine transaction.

Standby letters of credit play a significant role in the domestic and foreign trade. *See* DOLAN, *supra,* at ¶ 1.06; 3 WHITE & SUMMERS, UNIFORM COMMERCIAL CODE, PP-108-110 (4th Ed. 1995). Standby letters of credit not only serve to shift the credit risk from a seller such as Koch to the bank issuing the letter of credit, they also facilitate flexible pricing arrangements, as they did in this

case.[11] The decision below destroys the usefulness of standby letters of credit for these purposes, regardless of whether the obligation of the bank issuing the letter of credit is secured, unsecured or, as in the instant case, undersecured. No other instrument exists that could fill the void. *See* DOLAN, *supra,* at ¶ 2.01.

Heretofore, a buyer could assure a seller of future payment by depositing funds with a bank sufficient to cover the future payment and paying the bank a modest fee to promise the seller that when payment is due, the bank will, in effect, turn the funds over to the seller if the buyer does not pay. Such an arrangement is no longer possible following the decision of the Court of Appeals in this case.

Now, in order to protect itself from a fate like that met by Petitioner Koch in this case, a seller would have to insist that the buyer's bankruptcy be included as an event triggering its right to draw down a letter of credit, even if the petition is filed after the debtor has made payment, and that the issuing bank's obligation on the letter of credit remain in force until such time as the beneficiary can know with certainty that the payment received from the debtor cannot be taken away from it in a bankruptcy proceeding. Under these circumstances, an issuing bank (in the unlikely event it would consider

---

[11] For purposes of calculating the price of the crude oil, the Powerine/Koch contracts provided that the delivery of the crude oil would be deemed to be made in equal daily quantities throughout the month of delivery, even though the crude oil was not delivered in this manner. Because price changes occurring after the actual delivery of crude oil would affect the price of the crude oil, it was impossible to determine the actual price of the crude oil until the first day of the month following delivery. (Uncontroverted Facts, ¶¶ 9, 10).

issuing a letter of credit to a buyer at all) undoubtedly would require its customer to provide additional security for this additional risk. To be safe, an issuing bank will find it necessary, not only to require its customer to "put it in funds" before paying on a letter of credit, but also to "put it in funds" out of which the bank can reimburse itself for paying a draw-down after it releases its original security in order to enable its customer to pay a creditor, lest the creditor subsequently be found to have been preferred.[12]

This would mark the end of the usefulness of the standby letter of credit in facilitating the movement of trade goods. Prior to the ruling of the Court of Appeals in this case, standby letters of credit gave creditors confidence that they would receive a nonpreferential payment, even from an insolvent debtor. Under the Court of Appeals' novel preference analysis, trade creditors can never be certain of receiving a nonpreferential payment by a debtor. This uncertainty will cause some creditors to forgo extending credit to financially weak companies, thereby hastening their slide into bankruptcy. Coupled with the knowledge that draw-downs of letters of credit are not preferential, such uncertainty also may encour-

---

[12] As a practical matter, the necessity for this additional security would force abandonment of the practice of allowing the debtor to make payments out of the accounts securing a letter of credit. Consequently, a debtor making payment of a trade debt secured by a standby letter or credit would be required to keep the issuing bank in funds for a minimum of three months following making payment to the creditor. From the debtor's point of view, it would be foolish to pay rather than default under those circumstances. From the viewpoints of all three parties involved, the "standby" qualities of such arrangements would cease to exist; they would have nothing more to offer than traditional commercial letters of credit.

age creditors to assert any default, no matter how inconsequential, in order to seek payment under standby letters of credit whenever they become uncomfortable with a debtor's performance, thereby precipitating a cascade of events culminating in bankruptcy.

CONCLUSION

For the reasons stated herein, this Court should grant the writ and reverse the decision below.

Respectfully submitted,

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(2)

95-909

No.

Supreme Court, U.S.
FILED
DEC 6 1995
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AGAINST POWERINE OIL COMPANY, DEBTOR IN BANKRUPTCY,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

APPENDIX TO THE PETITION FOR WRIT OF CERTIORARI

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APPENDIX A

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: POWERINE OIL COMPANY, *Debtor.*	No. 92-56077
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, *Appellant,* v. KOCH OIL COMPANY, *Appellee.*	BAP No. CC-90-1344-OjP OPINION

Appeal from the
Ninth Circuit Bankruptcy Appellate Panel
Ollason, Jones, and Perris,
Bankruptcy Judges, Presiding

Argued and Submitted
December 7, 1994—Pasadena, California

Filed July 12, 1995

Before: Jerome Farris, Cecil F. Poole
and Alex Kozinski, Circuit Judges.
Opinion by Judge Kozinski; Dissent by Judge Farris

SUMMARY

Bankruptcy/Preferential Transfers

The court of appeals reversed a decision of the Ninth Circuit Bankruptcy Appellate Panel (BAP) and remanded. The court held that the BAP erred in considering the right to draw on third-party letters of credit deciding whether an unsecured creditor had received a preference.

Powerine Oil Co. obtained a $250.6 million line of credit from a syndicate consisting of several banks and insurance companies. The loan was secured by most of Powerine's personal property. The security agreement provided that the collateral would serve as security for all letters of credit that had been or were issued in the future on Powerine's account.

Appellee Koch Oil Co. agreed to sell crude oil to Powerine. To secure Powerine's obligation, it designated Koch as beneficiary of two irrevocable standby letters of credit issued by First National Bank of Chicago, one of the lenders covered by the security agreement. The letters, which were to expire in 1984, covered the cost of the oil.

Less than 90 days after Powerine paid Koch $3.2 million for oil it had delivered, Powerine filed a chapter 11 bankruptcy petition. Appellant the Committee of Creditors Holding Unsecured Claims brought an action to recover the payment, claiming it was a preference. The bankruptcy court held that the transfer was protected by the "contemporaneous exchange for new value" exception and granted Koch's motion for summary judgment.

The BAP affirmed on a different ground, holding that the payment was not a preference because it did not enable Koch to recover more than it would in a chapter 7 liquidation. The BAP reasoned that, even if Powerine had not made the $3.2 million transfer, Koch would have been paid in full because it would have drawn on First

National's letters of credit. The BAP invoked a "rule of reason" to avoid what it viewed as an inequitable result. The BAP held that Koch's right to collect under the letters could be taken into account because the letters of credit had expired by the time the Committee initiated its preference action. The Committee appealed.

[1] Vis-a-vis Powerine, Koch was an unsecured creditor as it did not hold any security interest in Powerine's property. Because most of Powerine's assets on the date it filed for bankruptcy were subject to the lien held by the secured creditors, Powerine's unsecured creditors could expect to receive much less than one-hundred cents on the dollar in a chapter 7 liquidation. Consequently, Powerine's $3.2 million pre-petition payment enabled Koch to recover more than it would have in a chapter 7 liquidation, and it was, therefore, a preference. [2] That Koch had recourse against a third party in case the debtor defaulted had no bearing on the issue of whether the payment was a preference. [3] It was error to consider the right to draw on third-party letters of credit in deciding whether Koch had received a preference. Statutory language provided no basis for the BAP's "rule of reason."

[4] First National was only partially secured, and it did not have first claim on the security. [5] Only a portion of First National's contingent reimbursement claim was secured by the blanket lien. When Powerine paid Koch directly, First National's exposure under the letters of credit was reduced by a corresponding amount, and its contingent claim against Powerine's assets was thereby released, but only to the extent the claim was secured. Thus, Powerine received new value equal to the amount of the secured portion of First National's reimbursement claim. As to the unsecured portion of First National's claim, however, Powerine did not receive new value. The

"contemporaneous exchange for new value" exception, therefore, did not protect Koch's $3.2 million payment to the extent First National's reimbursement claim was unsecured. [6] The case was remanded for the bankruptcy court to determine what portion of the $3.2 million payment could be recovered from Koch.

Circuit Judge Farris dissented, stating that the plain language of 11 U.S.C. § 547(b)(5) did not limit consideration to funds from Powerine's estate.

COUNSEL

Thomas A. Ryan, McDermott, Will & Emory, Los Angeles, California, for the appellant.

Michael R. Hassan, Lord, Bissell & Brook, Chicago, Illinois, for the appellee.

OPINION

KOZINSKI, Circuit Judge.

Can an unsecured creditor be better off when the debtor defaults rather than paying off the debt? Yes: Law can be stranger than fiction in the Preference Zone.

I

Powerine Oil Company (the debtor here) obtained a $250.6 million line of credit from a syndicate consisting of several banks and insurance companies; the loan was secured by most of Powerine's personal property. The security agreement provided that the collateral would serve as security for all letters of credit that "have been, or are in the future, issued on the account of Debtor." ER 101-02.

Koch Oil Company thereafter agreed to sell crude oil to Powerine. To secure Powerine's obligation, it designated Koch as beneficiary of two irrevocable standby letters of credit issued by First National Bank of Chicago, one of the lenders covered by the security agreement. The letters, which were to expire in April 1984, totaled approximately $8.7 million, an amount at all times sufficient to cover the cost of the oil Koch sold to Powerine.

In January and February 1984, Koch billed Powerine $3.2 million for oil it had delivered in December and January. Powerine eventually paid this amount but, unfortunately for Koch, it also filed a chapter 11 bankruptcy petition less than 90 days later. The Committee of Creditors Holding Unsecured Claims (the Committee) eventually brought an action to recover the payment, claiming it was a preference under 11 U.S.C. § 547(b).[1]

The bankruptcy court held that the transfer was protected by the "contemporaneous exchange for new value" exception of 11 U.S.C. § 547(c)(1) and granted Koch's motion for summary judgment. the Bankruptcy Appellate Panel (BAP) affirmed on a different ground: It held that the payment wasn't a preference because it didn't enable Koch to recover more than it would in a chapter 7 liqui-

---

[1] Pursuant to Powerine's reorganization plan, any preferential transfers recovered for the estate will be divided equally between secured and unsecured creditors. The full amount of the January and February payments was $8.5 million, but only $3.2 million was paid more than 45 days after delivery. We agree with the BAP that Powerine incurred its debts on the date Koch delivered the oil, not (as Koch argues) the first date the exact amount of the debt could be determined. Accordingly, $3.2 million of the transfer wasn't covered by the "ordinary course of business" exception under the version of 11 U.S.C. § 547(c)(2) in effect at the time of the transfer. *See In re Gold Coast Seed Co.*, 751 F.2d 1118, 1119 (9th Cir. 1985).

dation. Even if Powerine hadn't made the $3.2 million transfer, the BAP reasoned, Koch would have been paid in full because it would have drawn on First National's letters of credit.

II

Bankruptcy Code section 547(b) sets forth the five elements of a preferential transfer.[2] The parties dispute only whether the last element—section 547(b)(5)—was satisfied here. Under this provision, the Committee must prove that Koch "received more than it would [have] if the case were a chapter 7 liquidation case, the transfer had not been made, and [Koch] received payment of the debt to the extent provided by the provisions of the Code." 4 Collier on Bankruptcy ¶ 547.08, at 547-45 (Lawrence P. King ed., 15th ed. 1995).

---

[2] Section 547(b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition . . .
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (1986).

Whether section 547(b)(5)'s requirements have been met turns in part on the status of the creditor to whom the transfer was made. Pre-petition payments to a fully secured creditor generally "will not be considered preferential because the creditor would not receive more than in a chapter 7 liquidation." *Id.* at 547-47. With respect to unsecured creditors, however, the rule is quite different: "[A]s long as the distribution in bankruptcy is less than one-hundred percent, *any* payment 'on account' to an unsecured creditor during the preference period will enable that creditor to receive more than he would have received in liquidation had the payment not been made." *In re Lewis W. Shurtleff, Inc.*, 778 F.2d 1416, 1421 (9th Cir. 1985).

[1] Vis-a-vis Powerine, Koch was an unsecured creditor as it didn't hold any security interest in Powerine's property. *See* 11 U.S.C. § 506(a). Because most of Powerine's assets on the date it filed for bankruptcy were subject to the lien held by the secured creditors, Powerine's unsecured creditors could expect to receive much less than one-hundred cents on the dollar in a chapter 7 liquidation. Consequently, Powerine's $3.2 million pre-petition payment enabled Koch to recover more than it would have in a chapter 7 liquidation, and it was therefore a preference.

The BAP came to the contrary conclusion by focusing on the fact that Koch could have drawn down the letters of credit, had Powerine not paid it directly. Since Koch would have recovered the full amount owed to it (albeit from First National) had Powerine defaulted, the BAP reasoned that the $3.2 million payment wasn't a preference.

[2] Courts have long held, however, that the key factor in determining whether a payment is a preference is the "percentage[ ] . . . [creditors'] claims are entitled to draw

out of the *estate of the bankrupt.*" *Swarts* v. *Fourth Nat'l Bank*, 117 F. 1, 7 (8th Cir. 1902) (emphasis added). Thus, the relevant inquiry focuses "not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout" from the debtor's estate. *In re Virginia-Carolina Fin. Corp.*, 954 F.2d 193, 199 (4th Cir. 1992); *see also In re Formed Tubes, Inc.*, 41 B.R. 819, 821-22 (Bankr. E.D. Mich. 1984). That Koch had recourse against a third party in case the debtor defaulted thus has no bearing on this issue.

The BAP nonetheless invoked a "rule of reason" to avoid what it viewed as an inequitable result. ER 150. Koch's right to collect under the letters could be taken into account, the BAP held, because the letters of credit had expired by the time the Committee initiated its preference action. Koch was thus left far worse off because Powerine paid its bill rather than defaulting. The BAP recognized that a creditor's "rights against a surety are not relevant to whether a transfer is preferential so long as those rights are still in place after the preference action is commenced." It concluded, however, that "when that right of action against the surety no longer exists, it is incumbent upon the court to measure the net recovery that the transferee would have obtained from the surety had the transfer not been made." ER 150. The BAP cited no authority for this proposition and we construe it to have been an exercise of its equitable powers.

[3] Although bankruptcy courts are sometimes referred to as courts of equity, the Supreme Court has reminded us that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worth-*

ington v. *Ahlers*, 485 U.S. 197, 206 (1988). Equity may not be invoked to defeat clear statutory language, nor to reach results inconsistent with the statutory scheme established by the Code. *See In re Kelly*, 841 F.2d 908, 913 n.4 (9th Cir. 1988); *In re Shoreline Concrete Co.*, 831 F.2d 903, 905 (9th Cir. 1987). Because the statutory language here provides no basis for the BAP's "rule of reason," we conclude that it was error to consider the right to draw on third-party letters of credit in deciding whether Koch had received a preference.

III

Having determined that Powerine's $3.2 million payment to Koch was preferential under section 547(b), we must next determine whether any of section 547(c)'s exceptions apply. Placing heavy reliance on *In re Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224 (5th Cir. 1988), Koch contends the payment it received is protected by the "contemporaneous exchange for new value" exception of 11 U.S.C. § 547(c)(1).[3] In *Fuel Oil*, the debtor paid one of its unsecured creditors within 90 days of filing for bankruptcy. Like Koch, the creditor was the beneficiary of two letters of credit securing payment if the debtor defaulted. The issuing banks "held a security interest in [debtor]'s assets which at all times was equal to or in excess of [debtor]'s obligation to [the creditor]." *Id.* at 228.

---

[3] Section 547(c)(1) provides:

> The trustee may not avoid under this section a transfer . . . to the extent that such transfer was—
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange.

11 U.S.C. § 547(c)(1).

The Fifth Circuit held that the payment was protected by the contemporaneous exchange for new value exception, reasoning that, when the debtor paid the creditor, the banks' exposure under the letters of credit was reduced by a corresponding amount. The banks' contingent reimbursement claim against the debtor's assets was thereby released, giving the debtor new value. "This outcome is consistent with the principle underlying § 547(c)(1)," the Fifth Circuit noted, "because the release of the debtor's collateral offsets the transfer to the creditor, thereby resulting in no depletion to the debtor's estate." *Id.*; *see also In re E.R. Fegert, Inc.*, 887 F.2d 955, 959 (9th Cir. 1989).

[4] Unlike the banks in *Fuel Oil Supply*, which were fully secured, however, First National was only partially secured. When Powerine filed for bankruptcy, it had $282 million in secured debt and assets of only $66 million. Nor did First National have first claim on the security because the loan agreement provided that Powerine's debts would be secured "equally without preference or priority of any one over the other." ER 101.

[5] Only a portion of First National's contingent reimbursement claim was thus secured by the blanket lien. When Powerine paid Koch directly, First National's exposure under the letters of credit was reduced by a corresponding amount, and its contingent claim against Powerine's assets was thereby released, but only to the extent the claim was secured. Thus, Powerine received new value equal to the amount of the secured portion of First National's reimbursement claim. *See In re Robinson Bros. Drilling, Inc.*, 877 F.2d 32, 33-34 (10th Cir. 1989). As to the unsecured portion of First National's claim, however, Powerine didn't receive new value; the bank couldn't release a security interest in Powerine's assets it didn't in

fact have. The contemporaneous exchange for new value exception therefore doesn't protect Koch's $3.2 million payment to the extent First National's reimbursement claim was unsecured.

* * *

[6] We are unable to determine on this record how much of First National's contingent reimbursement claim against Powerine was secured. We therefore remand for the bankruptcy court to determine what portion of the $3.2 million payment may be recovered from Koch.

REVERSED and **REMANDED.**

FARRIS, Circuit Judge, dissenting:

Bankruptcy courts sit as courts of equity, but they may not avoid the plain language of a statute. *In re Shoreline Concrete Co.*, 831 F.2d 903, 905 (9th Cir. 1987). We must decide whether the Bankruptcy Appellate Panel's interpretation of 11 U.S.C. § 547(b)(5) is plausible.

Section 547(b)(5) states:

> [T]he trustee may avoid any transfer of an interest of the debtor in property—
>
> . . .
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The plain language of the statute does not limit consideration to funds from Powerine's estate. Under a hypothetical

chapter 7 liquidation, it could have collected from First National as "provided by the provisions of this title." In its opinion, the BAP ruled that "[n]othing in title 11 would prevent a draw down on the credits here at issue had Powerine filed bankruptcy without paying Koch."

In my opinion, the BAP's decision does not avoid the plain language of section 547(b)(5). I respectfully dissent.

APPENDIX B

[NOT FOR PUBLICATION]

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re:	)	BAP No.
	)	CC-90-1344-OJP
POWERINE OIL COMPANY,	)	
	)	Bk. No.
Debtor.	)	LA 84-7086-JD
	)	
	)	Adv. No.
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS,	)	LA 86-0897-JD
Appellant,	)	
v.	)	**MEMORANDUM**
	)	
KOCH OIL COMPANY,	)	
Appellee.	)	

Argued and Submitted on
July 17, 1991, at Pasadena, California

Filed July 23, 1992

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable James R. Dooley, Bankruptcy Judge, Presiding

Before: OLLASON, JONES, and PERRIS,
Bankruptcy Judges

Appellant Committee of Creditors Holding Unsecured Claims ("Committee") commenced an adversary proceeding to avoid alleged preferential transfers to Appellee Koch Oil Company ("Koch"). On cross motions for summary judgment, the bankruptcy court held that the payments constituted contemporaneous exchanges for new value which could not be avoided. We conclude that the new value defense was not fully available, but that the transfers were not preferential. Accordingly, we affirm the judgment of the bankruptcy court.

FACTS

Koch supplied crude oil. Debtor Powerine Oil Company ("Powerine") refined it. Koch regularly sold crude to Powerine, billing monthly for deliveries made during the preceding month. Consistent with their agreement and industry practice, the price of the crude was undetermined at the time of delivery. Instead, all of the oil was deemed delivered in equal amounts on each day of the month. Koch then billed Powerine at the daily rate reflected in an industry index. Neither the average daily delivery nor the price in effect each day could be determined until after the month in which the deliveries were made.

To ensure payment, Powerine opened two standby letters of credit in 1982 and 1983 at First National Bank of Chicago ("FNBC"). At all pertinent times, the credits totaled approximately $8,700,000. Koch could draw down the proceeds of the letters in the event that Powerine failed to make timely payment. The pertinent letters of credit expired by their terms on April 30, 1984.

Powerine was obligated to reimburse FNBC in the event of a draw down. That obligation was secured by Powerine's checking account at FNBC as well as other

assets. The agreement which gave rise to that security interest was entered into on May 29, 1981. It provided, in part:

> For value received, Debtor hereby assigns to Secured Party, as Trustee, and grants to Secured Party as Trustee, a security interest in, the collateral for the purpose of securing equally without preference or priority of any one over the other:
>
> A. Payment of the indebtedness evidenced by the Bank Notes and the Insurance Company Notes (collectively, the "Notes");
>
> B. Payment of obligations of Debtor to any one or more of the Banks under applications for letters of credit under which letters of credit have been, or are in the future, issued on the account of Debtor in favor of vendors of crude oil sold to Debtor.

The trustee under that agreement was Union bank, and the beneficiaries consisted of several insurance companies and banking institutions, including FNBC. At all material times, there was enough cash in the checking account to fully cover obligations arising from the letters of credit. However, the account balance was not sufficient to cover all of the obligations it secured.

Koch delivered 31,000 barrels of crude oil to Powerine on December 2-3, 1983, and another 124,000 barrels on December 9-12, 1983. On January 16, 1984, Koch billed Powerine $4,255,788.36 for those December deliveries. Full payment was made by wire transfer on January 20, 1984. On February 21, 1984, shortly after being billed for periodic crude oil deliveries during January, Powerine paid Koch $4,295,112.34, again by wire transfer. Both of those wire transfers were made with funds from Powerine's checking account at FNBC. In March, Powerine was billed $4,421,288.35 for the February shipments, but did not pay. Koch then drew down the letters of credit. FNBC then

debited Powerine's checking account for the full amount of the draw down pursuant to its contingent indemnification rights.

Powerine petitioned for relief under Chapter 11 of the bankruptcy code on March 26, 1984, scheduling $282 million in secured debt along with assets worth $66 million. Thereafter, the Committee commenced an adversary proceeding against Koch seeking to set aside the two wire transfers of January and February, both of which occurred within 90 days of Powerine's bankruptcy. The complaint alleged that the transfers constituted a preference under 11 U.S.C. § 547(b)[1] in the amount of $8,550,900.70. Koch answered and asserted that the transfers were protected from avoidance by § 547(c)(1) as a contemporaneous exchange for new value and by § 547(c)(2) as a payment in the ordinary course of business.

The Committee later amended its complaint to seek only $3,209,425.81, conceding that the rest of the payments were made within 45 days after coming due and were thus insulated by the ordinary course of business defense found in § 547(c)(2). Although that subsection no longer expressly requires that a payment in the ordinary course of business be made within 45 days after the debt is incurred, prior law applies to the subject transfers. The delivery of December 2-3, 1983, clearly preceded the payment made on January 20, 1984, by more than 45 days. The delivery of December 9-12, 1984, clearly did not precede the payment made on January 20, 1984, by more than 45 days. Similarly, only a portion of the February payment compensated Koch for January deliveries made more than 45 days before.

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[1] Unless otherwise stated, all references to "sections" refer to the Bankruptcy Code, 11 U.S.C. §101 (1988) et seq.

On cross-motions for summary judgment, the bankruptcy court found that the transfers then at issue, in the amount of $3,209,425.81, were not subject to the ordinary course of business defense because they trailed delivery by more than 45 days. The court also found that the payments could not have been made unless FNBC released its lien on a like amount of funds in Powerine's checking account. Accordingly, the court concluded that the transfers were contemporaneous exchanges for new value and hence not avoidable:

> The letters of credit insured Koch would receive full payment in lieu of performance, and that the debtors checking account as collateral fully secured the bank. When the bank released its security interest in the checking account new value was given to the debtor. *Matter of Fuel Oil Supply and Terminaling, Inc.*, 837 F.2d 224, 228 (5th Cir. 1988); *Cf. In re E.R. Fergert, Inc.*, 88 B.R. 258 (9th Cir. BAP 1988). The release of the debtor's collateral offsets the transfer to the creditor, thereby resulting in no depletion to the debtor's estate. [Citations omitted]. Therefore, the court finds that 11 U.S.C. §547(c)(1) protects the transfer to Koch from avoidance.

The Committee brought this timely appeal, contending that neither the contemporaneous exchange for new value defense nor the ordinary course of business defense are applicable to the transfers at issue. Koch contends that both apply.

ISSUES AND STANDARD OF REVIEW

The questions presented for review are whether the payments to Koch were made as a contemporaneous exchange for new value and whether they were made in the ordinary course of business. The material facts were not disputed and judgment was entered summarily. We

review questions of law and summary judgments *de novo*. *Darring v. Kincheloe*, 783 F.2d 874, 876 (9th Cir. 1986); *In re California Trade Technical Schools, Inc.*, 923 F.2d 641 (9th Cir. 1991).

DISCUSSION

The Committee contends that the debt was incurred upon delivery for the purpose of determining the 45-day period. If we accept that position, Koch argues persuasively that industry practice and its contracts with Powerine make the ordinary course of business defense of former § 547(c)(2) virtually inapplicable to payments for crude oil deliveries made near the beginning of the month. Because the price of each month's deliveries could not be fixed until its conclusion, as much as 30 days could elapse from delivery to price calculation, thereby substantially shortening the 45 day "window" contemplated by the statute. Koch cites *In re H & A Construction Co., Inc.*, 65 B.R. 213 (Bankr. D. Mass. 1986), *In re Georgia Steel, Inc.*, 38 B.R. 829 (Bankr. M.D. Ga. 1984), *In re Thomas W. Garland, Inc.*, 19 B.R. 920 (Bankr. E.D. Mo. 1982), and *In re Mindy's, Inc.*, 17 B.R. 177 (Bankr. S.D. Ohio 1982), for the proposition that a more reasoned approach should guide the determination of when a debt is incurred. Those cases present a compelling logic, and explain, perhaps, why Congress repealed the 45 day limitation of former law. But under the law of this circuit, a debt is incurred upon delivery. *In re Gold Coast Seed Co.*, 751 F.2d 1118, 1119 (9th Cir. 1985).

The amount of a debt need not be determined for the debt to have been incurred. A debt is liability on a claim. 11 U.S.C. § 101(12) (Supp. 1990). Under § 101(4), a claim is a "right to payment, whether or not such right is re-

duced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *See also Barash v. Public Finance Corp.*, 658 F.2d 504, 510 (7th Cir. 1981); *In re Energy Coop., Inc.*, 80 B.R. 921 (Bankr. N.D. Ill. 1987). The bankruptcy court correctly determined that the passage of more than 45 days from delivery prevented Koch from relying on the ordinary course of business defense to shield the transfers from avoidance.

In concluding that Koch was protected by the contemporaneous exchange for new value defense of § 547(c)(2), the bankruptcy court relied on *In re Fuel Oil Supply and Terminaling, Inc.*, 837 F.2d 224 (5th Cir. 1988), and *In re E.R. Fergert, Inc.*, 88 B.R. 258 (9th Cir. BAP 1988). As in the subject case, those cases each involved a three faceted relationship in which the creditor had recourse against a third party in the event that the debtor failed to pay. Recourse pursuant to the letter of credit in *Fuel Oil*, and recourse pursuant to the guarantee in *Fergert*, each would have occasioned a fully secured obligation in favor of the third party and against the debtor. That contingent, secured liability was forever released, however, when those debtors paid their creditors. Those releases constituted new value equal in amount to the payments made. *Fergert*, 88 B.R. at 259-60; *Fuel Oil*, 837 F.2d at 228-31. The Committee attempts to distinguish the operative facts of *Fergert* and *Fuel Oil* from those presented here in two respects.

The Committee first points out that the payment by the debtor to the creditor in *Fergert* and *Fuel Oil* operated to extinguish the claim of the creditor against the third party. In *Fergert*, the debtor's payment triggered a release of the surety by the contractor creditor. In *Fuel Oil*, one of two letters of credit was specifically released

by the creditor; the other could not be drawn down before expiring because of the payment. In both *Fergert* and *Fuel Oil*, payment by the debtor to the creditor resulted in the third party's substantially contemporaneous release of its contingent indemnification claim against the debtor and the debtor's collateral.

Contrarily, the Committee notes that the letters of credit presently under inquiry did not expire and were not released upon payment by Powerine for the crude oil deliveries. Instead, they remained in full force and were indeed drawn down the following month. Because those letters were not released, Powerine remained subject to FNBC's secured, contingent indemnification rights, which in fact resulted in a debit to Powerine's checking account after the March draw down. The Committee thus argues that no new value was given by Koch or received by debtor because the letters of credit were not expressly released. We disagree.

Each time a wire transfer was made to Koch from debtor's account, FNBC's exposure on the letters of credit was reduced in a like amount. For each reduction in FNBC's exposure on the letters, there was a corresponding release of its right to indemnity from debtor's account. A new shipment would give birth to a new obligation and payment would lay it to rest. Thus, at the time of each transfer, a secured, contingent indemnification liability exactly equal to the payment was released. Had the credits been expressly released or entirely drawn down due to non-payment, Koch would have shipped at its own peril. But with the same letters of credit unused and still in place, subsequent shipments required no further agreements. Koch and Powerine simply preferred a long term arrangement to several short ones. The issuance of monthly letters of credit, instead of the longer term documen-

tary credits used here, would not have affected "the equality of distribution of estate assets" which is the chief concern of § 547. *See In re Fergert*, 88 B.R. at 259.

The second distinction noted by the Committee is that the contingent indemnification liability in *Fuel Oil* and *Fergert* would have resulted in third party claims against the debtors that were fully secured by assets of their respective estates. Payments to the creditors in those cases thus had no impact upon the distribution to creditors of those debtors. *Fuel Oil*, 837 F.2d at 230-31; *Fergert*, 88 B.R. at 259.

In contrast, the security agreement allowing FNBC to collect from Powerine's checking account in the event of a draw down also encompassed numerous other obligations of Powerine that vastly exceeded Powerine's assets. Had no transfers been made to Koch from Powerine's checking account, Koch would have drawn down the documentary credits issued by FNBC. FNBC would then have had an indemnification claim against Powerine in a like amount, secured by Powerine's checking account.

The balance of that checking account would not have been reduced on account of Koch's satisfaction, and the additional funds retained by not making the payment would have equaled exactly the amount of FNBC's secured indemnification claim. Because the claims against Powerine's checking account exceeded its balance, however, they were not fully secured. Since the agreement of May 29, 1981, made the account "collateral for the purpose of securing equally without preference or priority of any one over the other," FNBC was secured only by a portion of the balance equal to its portion of the debt. Accordingly, FNBC's indemnity claim upon draw down would have been partially secured and partially unsecured. Extinction of that contingent claim provided new value

only to the extent that it would have been secured. The § 547(c)(1) defense is not available as to that portion of the transfer to Koch which would otherwise have resulted in the unsecured portion of FNBC's contingent indemnity claim.

Nevertheless, it seems incongruous to us that Koch, who billed Powerine promptly and was paid only four days thereafter, must disgorge notwithstanding that it would have recovered fully on the now expired letters of credit had payment not been made. Powerine entered into an agreement with FNBC whereby FNBC would bear the risk of Powerine's inability to pay Koch. Koch entered into an agreement with Powerine that was conditioned upon FNBC, rather than Koch, bearing the risk of Powerine's inability to pay Koch. Presumably, FNBC was compensated for bearing that risk. If Powerine's tender to Koch is preferential as to Koch, and if Koch cannot now draw down on the expired credits, these agreements will be nullified.

Avoidance would thus occasion an entirely different result than would have attached had no transfers occurred. Koch's recovery on the standby letters of credit would be replaced by an unsecured claim against the debtor, and all unsecured creditors would receive a smaller distribution on account of their claims. Avoidance would not, however, occasion the undersecured indemnity claim that would have resulted from a draw down if no transfers had been made. It would return funds to the collateral account, without the corresponding increase in claims against that account. Avoidance would thus provide a larger recovery for secured creditors at the expense of unsecured creditors.

The court in *Fuel Oil* expressly declined to consider the effect of § 547(b)(5) upon similar facts because it found the § 547(c)(2) defense clearly applicable. 837 F.2d at 227. The

elements of a preferential transfer are set forth in 11 U.S.C. § 547(b):

> Except as provided in subsection (c) of [§ 547], the trustee may avoid any transfer of an interest of the debtor in property—
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made—
> (A) on or within 90 days before the date of the filing of the petition; or
> (B) [within a year if such creditor was an insider]; and
> (5) that enables such creditor to receive more than such creditor would receive if—
> (A) the case were a case under chapter 7 of title 11;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of title 11.

The transfer in the case before us was a payment by the debtor, within the preference period and on account of an antecedent debt, to a creditor who was the beneficiary of certain letters of credit. Letters of credit allow supplying creditors such as Koch to obtain assurance without becoming immersed in the business of providing financial services. Their commercial utility rests upon certainty of payment when the required documents are tendered. *See KMW International v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 15 (2d Cir. 1979); 9 Kozolchyk, *Letters of Credit*, International Encyclopedia of Comparative Law Ch. 5, § 1 at 3-4, § 20.01 at 455 (1979).

Nothing in title 11 would prevent a draw down on the credits here at issue had Powerine filed bankruptcy without paying Koch. Neither a letter of credit nor its pro-

ceeds are property of a debtor's estate. *In re Air Conditioning, Inc.*, 845 F.2d 293 (11th Cir. 1988); *In re Security Services, Inc.*, 132 B.R. 411 (Bankr.W.D.Mo. 1991); *cf. Fuel Oil*, 837 F.2d at 229. Upon the occurrence of conditions precedent, the issuing bank must pay the beneficiary creditor upon demand. That obligation among nondebtors is wholly independent of the debtor and the debtor's arrangement with the issuing bank, and it is not stayed by 11 U.S.C. § 362. *Id.* at 416-17; *In re Val Decker Packing Co.*, 61 B.R. 831, 838-39 (Bankr.S.D.Ohio 1986) (and cases collected therein); *In re Prime Motor Inns*, 130 B.R. 610, 613-14 (S.D.Fla. 1991). Therefore, had Powerine failed to make the wire transfers, Koch would have drawn down in the amount of the transfers and would have had no claim against the estate. *See Id.*; *In re Security Services, Inc.*, 132 B.R. at 416-17 (and cases collected therein). The wire transfers thus did not enable Koch "to receive more than it would receive if the transfer had not been made and the debtor's estate was liquidated according to the provisions of the Bankruptcy Code." *In re California Trade Technical Schools, Inc.*, 923 F.2d 641, 642 (9th Cir. 1991).

The transfers did enable FNBC to recover more. As *Fuel Oil* recognized, debtor's "prebankruptcy performance effectively absolved the Banks of liability." 837 F.2d 224, 229. Had Koch drawn down, FNBC's indemnity claim would have been undersecured. Payment to Koch was thus equivalent to full payment on the undersecured indemnity claim FNBC would have had if the payments had not been made. By holding that new value received by a debtor need not be provided by the creditor to whom the transfer was made but may be provided by a fully secured third party, 837 F.2d 224, 231, *Fuel Oil* suggests that an issuer bank could be a constructive transferee of

a debtor's payment to a creditor beneficiary. *See also In re Security Services*, 132 B.R. at 416. But whether the wire transfer at issue here allowed FNBC to recover more than the Code would have provided is not before us, nor is FNBC, who would be indispensable to that inquiry.

Just as FNBC is not before us, the dissent pointedly notes that neither are any issues arising under 11 U.S.C. § 547(b)(5). The dissent further admonishes that the case law construing 11 U.S.C. § 547(b)(5)(C) does not permit consideration of a right to receive payment from third parties in deciding whether a transfer is preferential. *See In re Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bankr.E.D.Mich. 1984); *In re Hillcrest Foods, Inc.*, 40 B.R. 360, 365 (Bankr. D.Me. 1984). However, the facts of record clearly implicate § 547(b)(5), and plainly demonstrate that those cases are too broadly caged.

The primary thrust of Koch's position before the bankruptcy court was that the transfers were made on account of a debt that was fully secured by the documentary credits. That fact alone implicates § 547(b)(5) and the question regarding whether the transfers were preferential.

Under *Hillcrest* and *Formed Tubes*, Koch's right to look to FNBC for payment is not relevant to the question of whether the transfers to Koch from FNBC were preferential:

> A creditor may be secured, but a payment to him is not necessarily protected. Payment to a creditor is protected only if the creditor is secured by property of the estate and the property subject to its security interest equals or exceeds the amount paid to the creditor by the debtor.

Matter of Formed Tubes, Inc., 41 B.R. at 821. *Accord, In re Hillcrest Foods, Inc.*, 40 B.R. at 365. The rule

stated in those cases has its genesis in *Swarts v. Fourth National Bank*, 117 F. 1 (8th Cir. 1902):

> Those creditors who are entitled to receive out of the estate of the bankrupt the same percentage of their claims are in the same class, however much their owners may have the right to collect from others than the bankrupt. Their relations to third parties, their right to collect of others, the personal security they may have through indorsements or guaranties, receive no consideration, no thought. It is the relation of their claims to the estate of the bankrupt, the percentage of their claims are entitled to draw out of the estate of the bankrupt, and these alone, that dictate the relation of the creditors to the estate, and fix their classification and their preferences.

Id. at 7.

Swarts and its progeny would not allow consideration of the letters of credit in assessing whether Koch received more on account of the transfers than it would receive in liquidation. Rather, those cases require the court to consider only what Koch would have received from the estate in bankruptcy. That Koch would never have filed a claim, instead looking solely to the documentary credits, has no relevance under their test. § 547(b)(5)(C) directs the court to compare the amount of the transfers with the amount that would be paid if "such creditor received payment of such debt to the extent provided by the provisions of this title." That subsection does not direct a comparison with the amount that would be paid if "such creditor received payment from the debtor's estate."

As enacted, the statutory language permits a rule of reason when necessary carry out its intent. Its purpose is to maintain, rather than obfuscate, the distribution scheme contained in the bankruptcy code. A transferee's rights against a surety are not relevant to whether a

transfer is preferential so long as those rights are still in place after the preference action is commenced because avoidance would then place the parties in the same position they would have occupied in the absence of the transfer. But when that right of action against the surety no longer exists, it is incumbent upon the court to measure the net recovery that the transferee would have obtained from the surety had the transfer not been made. The transfer is preferential as to the transferee to the extent it exceeds that hypothetical recovery. The transfer is preferential as to the surety to the extent its liability on the guarantee is decreased by the transfer.

It the wire transfers had not been made in the subject case, Koch would have recovered fully on the credits. That fact is amply demonstrated by Koch's subsequent draw down on the same credits, which were in an amount sufficient to cover that draw down and the wire transfers presently at issue. Accordingly, all of the transfers to Koch were protected by the documentary credits or a defense under subsection (c).

CONCLUSION

Avoidance of a preferential transfer is purposed upon placing the estate and its creditors in the same position they would occupy had no transfer been made. Where a transferee's right to payment from a third party surety terminates after the challenged transfer but before its avoidance, the transferee's potential recovery from the surety is relevant to whether the transfer is preferential to the transferee under subsection (b)(5). Since the continuing documentary credits were in an amount sufficient to cover both the subsequent draw downs and the wire transfers here at issue, Koch recovered no more than it would have recovered under Title 11 had no transfers

been made. Accordingly, the judgment of the bankruptcy court is affirmed.

PERRIS, Bankruptcy Judge, dissenting:

While it may be commercially practical and equitable to protect Koch from preference liability, I do not believe that such a result may be reached under the pertinent statutory language. Although I agree with the majority that the transfer is not protected by sections 547(c)(1) and 547(c)(2), I disagree with the majority's conclusion under section 547(b)(5). Under the language of section 547(b)(5)(C), the pertinent focus is on the extent payment to the creditor is provided by the provisions of the Bankruptcy Code. The analysis should not consider the effect of the right to payments from third parties. *See In re Virginia-Carolina Financial Corp.*, 954 F.2d 193, 198-99 (4th Cir. 1992); *In re Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bank. E.D. Mich. 1984); *In re Hillcrest Foods, Inc.*, 40 B.R. 360, 365 (Bank. D. Me. 1984). Because the majority improperly considers potential third party payments, I believe that it misconstrues section 547(b)(5) and engages in the type of judicial legislation that has been condemned in recent Supreme Court decisions.[2] *See Patterson v. Shumate*, ___ U.S. ___, 112 S.Ct. 2242, 2250-51 (1992) (Scalia, J., concurring); *Union Bank v. Wolas*, ___ U.S. ___, 112 S.Ct. 527, 534 (1991) (Scalia, J., concurring). I therefore dissent.

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[2] I also question whether the majority's determination of this appeal on the basis of section 547(b)(5) involves impermissible factual findings by an appellate tribunal, *see In re Hall, Bayoutree Assoc., Ltd.*, 939 F.2d 802, 804 (9th Cir. 1991), especially given the summary judgment context of the bankruptcy court's decision and the fact that neither party raised this issue.

APPENDIX C

[Filed January 9, 1990]

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re:	No. LA 84-07086-JD
POWERINE OIL COMPANY, a California corporation,	Adv. No. LA 86-0897-JD
Debtor.	Chapter 11
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS,	Date: September 12, 1989 Time: 3:00 p.m.
Plaintiff,	Place: Courtroom E
vs.	
KOCH OIL COMPANY,	
Defendant.	

MEMORANDUM OF DECISION GRANTING DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

A motion for summary judgment may be granted only if there are no genuine issues of material fact to be tried and the moving party is entitled to summary judgment as a matter of law. Rule 56 of the Federal Rules of Civil

Procedure, which is made applicable to this case by Bankruptcy Rule 7056; *Anderson vs. Liberty Lobby*, Inc., 477 U.S. 242, 247-252 (1986); *Celotex Corp. vs. Catrett*, 477 U.S. 317, 322-327 (1986); *Matsushita Electrical Industrial Co. vs. Zenith Radio*, 475 U.S. 574, 585-587 (1986); *United Steel Workers of America vs. Phelps Dodge*, 865 F.2d 1539, 1541 (9th Cir. 1989); *Richards vs. Nielsen Freight Lines*, 810 F.2d 898, 902 (9th Cir. 1987); *T.W. Elec. Service vs. Pacific Elec. Contractors*, 809 F.2d 626, 630 (9th Cir. 1987).

The court has concluded that the defendant's cross-motion for summary judgment should be granted on the ground that new value was given in accordance with 11 U.S.C. §547(c)(1).

The letters of credit insured that Koch would receive full payment in lieu of performance, and that the debtors checking account as collateral fully secured the bank. When the bank released its security interest in the checking account new value was then given to the debtor. *Matter of Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224, 228 (5th Cir. 1988); Cf. *In re E.R. Fegert, Inc.*, 88 B.R. 258 (9th Cir. BAP 1988). The release of the debtor's collateral offsets the transfer to the creditor, thereby resulting in no depletion to the debtors estate. *Matter of Fuel Oil Supply & Terminaling, Inc.*, supra, at 228; *In re Auto-Train Corp.*, 49 B.R. 605, 612 (Bankr. D.C. 1985). Therefore, the court finds that 11 U.S.C. §547(c)(1) protects the transfer to Koch from avoidance.

It should be noted that the court in its ruling does not conclude that the payments were made in the ordinary course of business. With respect to this issue the court finds in favor of plaintiff's argument that under 11 U.S.C. §547(c)(2)(B), the payments were not made in the ordinary course of business.

Counsel for the defendant is directed to serve and lodge within 30 days from this date proposed findings of fact and conclusions of law and a proposed judgment both for the signature of the court. The findings of fact should consist of undisputed facts only determined in accordance with Local Bankruptcy Rule 111(5).

Dated: January 9, 1990

/s/ James R. Dooley
Bankruptcy Judge

[Certificate of Mailing omitted in printing.]

APPENDIX D

[Filed March 29, 1990]

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re:	Bk. No. LA 84-07086-JD [Chapter 11]
POWERINE OIL COMPANY, a California corporation, Debtor.	Adv. No. LA 86-0897-JD
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, Plaintiff, vs. KOCH OIL COMPANY, Defendant.	

FINDINGS OF FACT AND CONCLUSIONS OF LAW SUBMITTED BY DEFENDANT KOCH OIL COMPANY BASED UPON THE COURT'S MEMORANDUM DECISION OF JANUARY 9, 1990

FINDINGS OF FACT

1. The debtor, Powerine Oil Company ("Powerine"), filed a voluntary petition for relief under Chapter 11 of

the Bankruptcy Code on March 26, 1984. This adversary proceeding was instituted against defendant Koch Oil Company ("Koch") pursuant to 11 U.S.C. §§ 547 and 550 to avoid and recover certain transfers of property made by Powerine to Koch.

2. In its complaint, the plaintiff originally sought to recover $8,550,900.70 from Koch as allegedly preferential payments for crude oil, $4,255,788.36 of which was paid by Powerine on January 20, 1984 for December 1983 deliveries, and $4,295,112.34 of which was paid by Powerine on February 21, 1984 for January 1984 deliveries. In its answer, Koch pled affirmative defenses under 11 U.S.C. Section 547(c)(1) and (c)(2).

3. In its motion for summary judgment, plaintiff reduced the amount claimed as a preference. Plaintiff concedes that all of Powerine's debt to Koch was incurred in the ordinary course of the parties' business and that the disputed transfers were made in the ordinary course of the parties' business and according to ordinary business terms. (Plaintiff's Memorandum of Points and Authorities, pp. 4, 7, 13-15, 21) Plaintiff now claims, however, that of the $8,550,900.70 originally claimed in the complaint, $3,209,425.81 was paid more than 45 days after Powerine incurred a debt to Koch and that this latter amount is not shielded from avoidance under 11 U.S.C. §547(c)(2). Of the $3,209,425.81 the plaintiff claims, $862,386.35, was paid on January 20, 1984 for December 2 and 3, 1983 deliveries of crude oil and the remainder was paid on February 21, 1984 for January 1 through 6, 1984 shipments of crude oil.

4. In 1982 and 1983, Koch entered into two contracts with Powerine for the sale of specified amounts of crude oil to be delivered to Powerine via pipeline from Four Corner Pipeline Company's Hynes facility ("Four Corners")

to Powerine's receiving facility. In 1984, the parties entered into an agreement for the sale of specified amounts of crude oil to be delivered to Powerine's refinery by truck. (Declaration of Robert S. Dolechek, hereinafter "Dolechek Dec.", para. 4; Declaration of Henry Del Castillo, hereinafter "Del Castillo Dec.", paras. 5-8)

5. Powerine's obligations under all three contracts were secured by letters of credit in Koch's favor issued by the First National Bank of Chicago ("FNBC") that insured that Koch would receive full payment from FNBC if it elected to draw under the letter of credit rather than being paid directly by Powerine. (Deposition of Steven Eastwood, hereinafter "Eastwood Dep.", at 15-20 (11-14*); Group Exhibit 1 to Defendant's Statement of Uncontroverted Facts and Conclusions of Law, hereinafter "Defendant's Statement"; Plaintiff's Statement of Genuine Issues, para. 1)

6. If FNBC made a payment to Koch under the letters of credit, Powerine was obligated to reimburse FNBC in full. Powerine's obligation to reimburse FNBC was secured by, among other assets, the cash in Powerine's checking account at FNBC. (Eastwood Dep. at 12-15, 24-25 (8-11, 15-16); Deposition of Henry Del Castillo, hereinafter "Del Castillo Dep.", at 25 (63); Group Exhibits 1 and 2 to Defendant's Statement; Plaintiff's Statement of Genuine Issues, para. 1)

7. At all relevant times, there was sufficient cash in Powerine's FNBC checking account to fully secure Powerine's obligations to reimburse FNBC if FNBC made a

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* The page numbers in the parentheses represent the page numbers of the referenced material attached to Defendant's Statement of Uncontested Facts and Conclusions of Law.

payment to Koch under its letters of credit. (Eastwood Dep. at 25-26, 30-34 (16-17, 19-23)

8. Koch did not draw upon the letters of credit for the payments in dispute. Instead, Powerine instructed FNBC to wire transfer funds to Koch from Powerine's checking account at FNBC. This was the same checking account given as security for Powerine's obligations to FNBC. On January 20, 1984, Powerine paid Koch by wire transfer $4,255,788.36 for December crude oil deliveries, and on February 21, 1984, it paid Koch by wire transfer $4,295,112.34 for January deliveries. (Del Castillo Dec., paras. 11-14, 19-23, Exhibits 6, 7, 8, 9.1, 9.2, 14, 15, 16, 17, 18.1, 18.2 attached thereto; Plaintiff's Statement of Genuine Issues, para. 1)

9. FNBC released its security interest in the funds in Powerine's checking account to enable Powerine to transfer the funds from its checking account on January 20 and February 21, 1984 to make the above payments to Koch. If Koch, rather than having been paid directly by Powerine, had drawn upon the FNBC letters of credit for the payments in dispute, FNBC would have reimbursed itself by debiting Powerine's checking account in the amount of the draws. (Eastwood Dep. at 12, 24-34 (8, 15-23); Plaintiff's Statement of Genuine Issues, para. 1) There was thus no net depletion of Powerine's assets by the above described wire transfers.

10. Run tickets prepared by Four Corners and transmitted to Powerine show that deliveries of oil to Powerine from Koch through Four Corners occurred on December 2 and 3, 1983, and January 1, 2, and 3, 1984. (Del Castillo Dec., paras. 9, 15 and Exhibits 4, 10 attached thereto) The value of the crude oil delivered on these dates is $3,167,350.31. Powerine's payment on January 20, 1984 for

all of the December deliveries is more than 45 days from the December 2 and 3, 1984 deliveries. Powerine's payment on February 21, 1984 for all of the January deliveries is more than 45 days from the January 1, 2 and 3, 1984 deliveries.

* * * * *

CONCLUSIONS OF LAW

1. Jurisdiction of this Court is founded on 28 U.S.C. §§ 157 and 1334 (as enacted or amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984), in that this adversary proceeding is a civil proceeding which is a core proceeding arising under Title 11 of the United States Code and arising in a case under Title 11 of the United States, *In re Powerine Oil Company, a California corporation*, Bk. No. LA 84-07086-JD, United States Bankruptcy Court, Central District of California, and in that this adversary proceeding has been referred to this Bankruptcy Court by the United States District Court for the Central District of California.

2. Powerine's payments to Koch on January 20, 1984 and February 21, 1984 were part of contemporaneous exchanges for new value under 11 U.S.C. §547(c)(1) because in connection with each payment FNBC released its security interest in Powerine's checking account so that the funds could be transferred to Koch. The plaintiff is not entitled to recover any portion of the $8,550,900.70 Powerine paid Koch on those dates including the $3,209,425.81 which it now claims is preferential.

3. Under 11 U.S.C. Section 547(c)(2), Powerine incurred a debt to pay Koch for the crude oil on the dates specified on the run tickets prepared by Four Corners, i.e., December 2 and 3, 1983 and January 1, 2 and 3, 1984.

4. Powerine's debts to Koch were incurred in the ordinary course of business and its payments to Koch were made in the ordinary course of business and according to ordinary business terms under 11 U.S.C. Section 547(c)(2). Payments totalling $3,209,425.81 were made, however, more than 45 days after Powerine incurred a debt to Koch. These payments would not be shielded from avoidance under Section 547(c)(2).

/s/ James R. Dooley
United States
Bankruptcy Judge

Dated: March 29, 1990

Submitted By:

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[Affidavit of Service omitted in printing.]

APPENDIX E

[Filed March 29, 1990]

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re:	Bk. No. LA 84-07086-JD [Chapter 11]
POWERINE OIL COMPANY, a California corporation, Debtor.	Adv. No. LA 86-0897-JD
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, Plaintiff, vs. KOCH OIL COMPANY, Defendant.	

SUMMARY JUDGMENT

At Los Angeles, California, in said district, on this 29th day of March, 1990:

On September 12, 1989, the motion of plaintiff Committee of Creditors Holding Unsecured Claims for Sum-

mary Judgment and the cross-motion of defendant Koch Oil Company for summary judgment came on regularly for hearing before the undersigned United States Bankruptcy Judge. Marc Andrews of Danning, Gill, Gould, Diamond & Spector appeared on behalf of plaintiff and Michael R. Hassan of Lord, Bissell & Brook appeared on behalf of defendant.

After full consideration of the moving papers and all supporting papers, the opposition thereto, the entire contents of the court's files and the arguments of counsel, and the Court having issued its Memorandum of Decision Granting Defendant's Cross Motion for Summary Judgment, dated January 9, 1990, and the Court having adopted Findings of Facts and Conclusions of Law submitted by Defendant pursuant to this Court's Memorandum of Decision, it is hereby

ORDERED, ADJUDGED AND DECREED that Summary Judgment be entered in favor of defendant Koch Oil Company and against plaintiff Committee of Creditors Holding Unsecured Claims and that plaintiff pay defendant's costs of suit, and there is no just reason to delay enforcement or appeal of this order.

/s/ James R. Dooley
United States
Bankruptcy Judge

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[Verification omitted in printing.]

[Notice of Entry of Order and Certificate of Mailing omitted in printing.]

APPENDIX F

[Filed September 7, 1995]
NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: POWERINE OIL COMPANY, Debtor.	No. 92-56077
COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, Appellant, v. KOCH OIL COMPANY, Appellee.	BAP No. CC-90-1344-OjP ORDER

Before: FARRIS, POOLE and KOZINSKI, Circuit Judges.

A majority of the panel has voted to deny the petition for rehearing. The full court has been advised of the suggestion for en banc rehearing and no judge has requested a vote thereon. Therefore, the petition for rehearing is DENIED, and the suggestion for rehearing en banc is REJECTED. Fed. R. App. P. 35(b)

APPENDIX G

§ 547. Preferences.

(a) In this section—

(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;

(2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;

(3) "receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was—

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor—

(A) to the extent such security interest secures new value that was—

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt—

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.

(d) The trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the extent of the value of such property recovered by the trustee or the amount paid to the trustee.

(e)(1) For the purposes of this section—

(A) a transfer of real property other than fixtures, but including the interest of a seller or

purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; or

(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

...UTION FILED
DEC 6 1995

95-909

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AGAINST POWERINE OIL COMPANY, DEBTOR IN BANKRUPTCY,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE THE U.S. COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF PETITIONER

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Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

NOW COMES The U.S. Council on International Banking, Inc. ("USCIB"), and, with the consent of petitioner Koch Oil Company, but without the consent of respondent Committee of Creditors Holding Unsecured Claims Against Powerine Oil Company (which has refused consent), respectfully requests for the reasons described below that this Court grant this motion and receive the amicus brief of the USCIB, which supports the petition.

The USCIB is a non-profit association of the leading banks engaged in the United States in letter of credit operations. The USCIB supports the petition because the divided opinion of the Court of Appeals for the Ninth Circuit in this case severely and needlessly inhibits proper

uses of standby letters of credit. Standby letters of credit are legitimate and widely used security devices that are an important source of credit support for businesses that cannot buy new goods and services on an unsecured deferred payment basis. Payments to a supplier for goods delivered after issuance of a standby letter of credit should not be recoverable from the supplier as preferential. Like cashier's checks held until a transaction closes, transactions secured by standby letters of credit involve a substantially contemporaneous exchange and no net diminution of the purchaser's estate.

Preference challenges to standby letters of credit should be limited to those few that are taken during the applicable preference period to secure antecedent debt. The opinion in this case puts standby letters of credit worth billions of dollars at risk and will needlessly increase paperwork and costs as parties use more letters of credit requiring direct bank payments for each delivery. The opinion in this case thus impedes the free flow of commerce, needlessly increases the cost of credit, and devalues standby letters of credit.

Respectfully submitted,

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BRIEF OF AMICUS CURIAE THE U.S. COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF PETITIONER

INTEREST OF THE AMICUS CURIAE

The U.S. Council on International Banking, Inc. ("USCIB") is a non-profit association. Its over 350 members, listed in Appendix A, are domestic and foreign banks engaged in international banking operations, including letter of credit operations, in the United States. They account for over 90% of the letters of credit outstanding in the United States.

Since its establishment in 1924, the USCIB has played a leading role in the articulation of letter of credit law and practice. The USCIB initiated the drafting process

that preceded adoption of the Uniform Customs and Practice for Documentary Credits in 1933 and has played a significant role in each of the subsequent revisions. The USCIB was actively involved in the original codification and recent revision of domestic letter of credit law in Article 5 of the Uniform Commercial Code and in the development of an international Convention on Independent Guarantees and Stand-by Letters of Credit by the United Nations Commission on International Trade Law. Every year throughout the United States the USCIB organizes conferences and workshops and supplies speakers and materials for the continuing education of bankers and bank customers in letter of credit law and practice.

The USCIB's members are located in all U.S. centers of international banking and are involved in all aspects of letter of credit practice in an international as well as domestic context. Accordingly, the USCIB's interest is that letter of credit law and practice be workable, balanced, predictable, and universal. The USCIB is interested in letter of credit law and practice as applied in the courts, as well as at bank counters. In this regard, the USCIB desires that U.S. court decisions uphold the reliability and value of letters of credit and provide neither advantage nor disadvantage to U.S. letters of credit vis-à-vis the rest of the world.

SUMMARY OF ARGUMENT

Letters of credit are unique payment and security devices that, because they are "independent," are enforceable by the beneficiary against the issuing bank notwithstanding the applicant's bankruptcy. The letter of credit in this case was received before the beneficiary

extended credit to the applicant. It remained outstanding until, as contemplated by its "standby" terms, the beneficiary received payment from the applicant, and, having served its "standby" function, it expired. Each year standby letters of credit worth many billions of dollars similarly are issued and expire without drawing.

In this case, the payments received from the applicant by the beneficiary of a standby letter of credit were held to be preferential under 11 U.S.C. § 547(b). There is precedent for treating letters of credit as preferential to the extent that, when taken, they secure antecedent debt. The opinion in this case, however, goes far beyond that precedent. It penalizes a beneficiary for relying on a standby letter of credit as security for future transactions simply because the issuer is not fully secured by the applicant's assets, which is a matter beyond the beneficiary's knowledge or control. The opinion thus creates an unwarranted exception to the "independence" principle provided in domestic and international letter of credit law and practice, devalues outstanding standby letters of credit, and needlessly drives prospective users toward less efficient types of credit support.

ARGUMENT

Powerine Oil Company ("Powerine") requested First National Bank of Chicago ("FNBC") to issue irrevocable standby letters of credit in favor of petitioner Koch Oil Company ("Koch") to secure payment for future deliveries of oil by Koch to Powerine. After receiving FNBC's standby letters of credit, Koch sold and delivered oil to Powerine for which Koch received payment from Powerine. FNBC's standby letters of credit were at all times suffi-

cient in amount to pay the amounts due from Powerine in the event that Powerine failed to pay. *In re Powerine Oil Co.*, 59 F.3d 969, 971 (9th Cir. 1995).

Powerine filed a Chapter 11 bankruptcy petition more than 90 days after Koch received FNBC's standby letters of credit but fewer than 90 days after Koch received payment from Powerine. After that filing and after FNBC's standby letters of credit expired, Koch's receipt of payment was challenged as a preference under 11 U.S.C. § 547(b). The bankruptcy court held that the payment was protected by the "contemporaneous exchange for new value" exception of 11 U.S.C. § 547(c)(1). The Bankruptcy Appellate Panel held that the payment was not a preference under 11 U.S.C. § 547(b)(5), because it did not enable Koch to recover more than it would in a Chapter 7 liquidation. 59 F.3d at 971.

A divided Court of Appeals reversed, concluding that

> . . . it was error to consider the right to draw on third-party letters of credit in deciding whether Koch had received a preference.

59 F.3d at 973. The Court of Appeals also concluded that Powerine's payment to Koch was contemporaneously exchanged for new value to Powerine only to the extent that FNBC's reimbursement right against Powerine was secured by Powerine's assets. 59 F.3d at 973. On that basis, it remanded the case to the bankruptcy court to determine how much of FNBC's contingent reimbursement right was secured. 59 F.3d at 974.

The Court of Appeals decision treats a beneficiary's rights under a solvent bank issuer's standby letter of credit as valueless upon applicant bankruptcy, even though the beneficiary received the letter of credit before

extending credit to the applicant. The beneficiary's rights under the letter of credit were accorded no value in determining whether a payment received by the beneficiary from the applicant was a preference or whether it was exchanged for new value when received in lieu of drawing under the letter of credit. The Court of Appeals valued that exchange, not by reference to the drawing rights notionally released by the beneficiary to the issuer, but by reference to the collateral notionally released by the issuer to the applicant.

All letters of credit function "to substitute the financial integrity of a stable credit source (usually a bank) for [the applicant's] own." *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 815 (2d Cir. 1992). The issuer's obligation to pay the beneficiary's drawing under the letter of credit is independent of the applicant-issuer relationship expressed in the application for issuance of the letter of credit and is independent also of the applicant-beneficiary relationship expressed in the underlying sale or other contract secured by the letter of credit. An issuer is thus obligated to pay a demand that complies with the terms and conditions of the letter of credit, whether or not the issuer's reimbursement rights are secure. "The great utility of the letter of credit derives from the fact that these three relationships are utterly independent of one another." *Alaska Textile*, *supra*, at 815.

The "independence" of the letter of credit is recognized and relied upon in international practice. *See, e.g.*, Article 6 of the Uniform Customs and Practice for Documentary Credits, 1983 revision, International Chamber of Commerce Publication No. 400, *reprinted in* John F. Dolan, *The Law of Letters of Credit*, App. A (2d Ed. 1991)

("A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for the credit and the issuing bank.") The letter of credit "independence" principle is part of the law merchant. *See, e.g., Alaska Textile, supra*, at 816 ("Letters of credit are *sui generis* . . . governed by the *lex mercatoria* . . . and, in applying this body of law, we are appropriately solicitous of the necessities of commerce and of developments in other jurisdictions"); Section 5-103(d) of Revised Article 5 of the Uniform Commercial Code (1995) ("Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.")

Standby letters of credit commonly provide for drawings only after a default in the underlying transaction. *See FDIC v. Philadelphia Gear Corporation*, 476 U.S. 426, 428 (1986) ("Because the letter of credit was intended to provide payment to the seller only if the buyer of the invoiced goods failed to make payment, the letter of credit was what is commonly referred to as a 'standby' or 'guaranty' letter of credit.") These letters of credit literally "stand by" while the applicant and beneficiary exchange documents and payments directly, unlike commercial letters of credit under which documents for each delivery are presented to the issuer for payment. The standby is an extremely flexible and efficient type of letter of credit, particularly to secure payment for recurrent purchases of goods or services by a regular customer. A

single standby letter of credit may be issued to cover multiple transactions over a period of one or more years and be limited to an amount based on maximum exposure at any one time rather than the aggregate amount of all transactions to be covered during the life of the standby. The standby letter of credit thus avoids the paperwork and costs for all parties of issuing multiple commercial letters of credit or amendments and preparing and processing multiple drawings.

As of the close of 1994, the 300 largest domestic bank issuers had letters of credit outstanding in an amount exceeding $180 billion, of which over $30 billion were "commercial," $110 billion were "financial" standbys, and $40 billion were "performance" standbys. *See* 11 *Letter of Credit Update* 47-51 (August 1995). (Bank regulations categorize letters of credit as "commercial" or "standby" and distinguish "performance" standbys from "financial" standbys (*see, e.g.*, 12 CFR Pt. 3, App. A, § 3(b), fn. 13, 16)). Most "performance" and some "financial" standbys provide for drawing upon the applicant's failure to make a payment due to the beneficiary in the underlying transaction secured by the letter of credit. Accordingly, there are at any moment a significant number of letters of credit outstanding that "stand by" while the beneficiary awaits payment from the applicant and that provide for drawing on the issuer only if the applicant fails to pay the beneficiary. They are regularly released or allowed to expire after they have served their standby function, i.e., after the beneficiary has received all payments due from the applicant that are secured by the standby. While it is important to recognize the non-preferential status of payments received by a beneficiary from the issuer of a commercial letter of credit, it is

equally important to recognize the non-preferential status of payments received from the applicant that are secured by a standby letter of credit.

The cases applying the preference provisions of 11 U.S.C. § 547 in the context of bankruptcy of letter of credit applicants have generally respected the letter of credit "independence" principle that insulates performance of the issuer's obligations to the beneficiary from the applicant's obligations to the issuer. *See, e.g., Security Servs. Inc. v. National Union Fire Ins. Co.* (*In re Security Servs., Inc.*), 132 B.R. 411 (Bankr. W.D. Mo. 1991); *see generally Dolan, supra*, ¶ 7.03[3]. The case law and writers recognize an exception to the rule that letter of credit beneficiaries may rely on an issuing bank's undertaking without regard to the bankruptcy of the applicant. Excepted are beneficiaries that within the applicable preference period receive a letter of credit securing antecedent debt. *See, e.g., Kellogg v. Blue Quail Energy, Inc.* (*Matter of Compton Corp.*), 831 F.2d 586 (5th Cir. 1987), *modified*, 835 F.2d 584 (5th Cir. 1988); *American Bank v. Leasing Serv. Co.* (*In re Air Conditioning, Inc. of Stuart*), 845 F.2d 293 (11th Cir.), *cert. denied*, 488 U.S. 993 (1988); *see generally Dolan, supra* ¶ 7.03[3][a]. That exception to the recognition of the "independence" of a letter of credit is defensible, because in each case in which the exception applies the beneficiary knows that the letter of credit secures antecedent debt and should know that holding a letter of credit is equivalent, but not superior, to a cash advance. That beneficiary knowingly risks entry into the "Preference Zone."

That exception for letters of credit taken during the applicable preference period to secure antecedent debt is, however, not applicable to this case. This case falls with-

in the general rule, recognized worldwide, that a letter of credit is "independent," that its value to the beneficiary is dependent on its terms and conditions and on the solvency and reputation of the issuer, not of the applicant, and that the applicant's bankruptcy does not deprive the beneficiary of the security afforded by the letter of credit.

In applying the exception for letters of credit taken during the applicable preference period to secure antecedent debt, courts have quantified the preference to the beneficiary by valuing the collateral pledged by the applicant-debtor to the issuing bank. *See, e.g., Compton, supra*, at 595. This method of quantifying the preference is itself contrary to the letter of credit "independence" principle, in that it transforms a letter of credit issuer from a primary obligor into a mere agent holding collateral for the beneficiary. Moreover, this method involves ascertaining facts over which the beneficiary has no control and to which, in day to day practice, the beneficiary would be denied access. Its application in the context of preference litigation is justifiable only because it limits the amount that might otherwise be avoided under a letter of credit received during the applicable preference period to secure antecedent debt and for which the beneficiary has provided no new value. Where, however, the letter of credit was received before the beneficiary extended credit to the applicant, there is no wrong by the beneficiary to be remedied, no right to devalue the issuer's letter of credit obligation to the beneficiary by limiting it to the value of applicant collateral pledged to the issuer, and no reason to impose on the beneficiary the risk of applicant bankruptcy after the beneficiary has delivered goods in reliance on the letter of credit.

The panel majority's opinion in this case undermines the assurances given in *Compton* that the letter of credit "independence" principle would be respected so as to protect the rights of beneficiaries other than those receiving letters of credit to secure antecedent debt. In this regard, the *Compton* court stated as follows:

> Our holding does not affect the strength of or the proper use of letters of credit. When a letter of credit is issued contemporaneously with a new extension of credit, the creditor beneficiary will not be subject to a preferential attack under the direct/indirect doctrine elaborated in this case because the creditor will have given new value in exchange for the indirect benefit of the secured letter of credit. Only when a creditor receives a secured letter of credit to cover an unsecured antecedent debt will it be subject to a preferential attack under 11 U.S.C. 547(b).

Compton, supra, at 595.

When a letter of credit is issued contemporaneously with a new extension of credit, subsequent deliveries made and payments received for the deliveries, if secured by the letter of credit, are not preferential because there is no net diminution of the applicant's estate. A letter of credit joins the beneficiary's performance with the beneficiary's receipt of payment for that performance and makes them contemporaneous. If payment is not received from the applicant as contemplated by a standby letter of credit, then the beneficiary may obtain payment by drawing on the issuer. No provision of 11 U.S.C. § 547(b)(5), or chapter 7 of the Bankruptcy Code to which it refers, would inhibit receipt and retention of payment from the issuer made under the letter of credit. In calculating how much a letter of credit beneficiary would

receive in a hypothetical chapter 7 case, 11 U.S.C. § 547(b)(5) does not limit the calculation to amounts "distributed from" the hypothetical chapter 7 estate, but includes any payment received "to the extent provided by the provisions of this title." Similarly, in determining whether a "substantially contemporaneous exchange" has occurred, 11 U.S.C. § 547(c)(1) does not require that the effect of bank undertakings—whether in the form of letter of credit or escrow agreement or of cashier's check, certified check, or banker's acceptance held by a creditor—be ignored.

Unlike *Compton*, the panel majority's holding in the case before the Court undermines the strength of a properly used standby letter of credit. In addition to conflicting with the assurances given in *Compton*, the panel majority's opinion in this case conflicts with assurances of "independence" provided in domestic and international letter of credit law and practice. It upsets the reasonable expectations of letter of credit beneficiaries. It would devalue billions of dollars worth of standby letters of credit, and, in light of the impracticality of having beneficiaries monitor the value of applicant assets pledged to issuing banks, would deprive the letter of credit community of a very popular and useful security device for which there is no equally efficient substitute.

CONCLUSION

The U.S. Council on International Banking, Inc., as Amicus Curiae, urges the Court to grant the Petitioner a Writ of Certiorari.

Respectfully submitted,

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APPENDIX A

USCIB MEMBER INDEX BY STATE

ALABAMA

Amsouth Bank, N.A.
Compass Bank
First Alabama Bank
SouthTrust Bank of Alabama, N.A.

ARIZONA

Bank of America Arizona
Bank One, Arizona, N.A.
First Interstate Bank of Arizona

CALIFORNIA

Community Bank
Bank of America, N.T. & S.A.
Republic Bank California N.A.
National Bank of Long Beach
ABN Amro Bank, N.V.
American Express Bank Int'l
Asahl Bank, Ltd., The
Bancomer, S.A., Los Angeles Int'l Banking Branch
Banque Paribas
City National Bank
Credit Suisse
Dai-Ichi Kangyo Bank of California
Eastern International Bank
Far East National Bank
Fuji Bank Ltd
LIPPOBANK
Manufacturers Bank
Mitsubishi Bank Ltd., The
Mitsubishi Trust & Banking Corporation
P.T. Bank Dagang Nasional Indonesia

Philadelphia International Bank
Sanwa Bank California
Standard Chartered Bank
State Street Bank International
Union Bank, Monterey Park
Imperial Bank, Redondo Beach
ABN Amro Bank, N.V.
Bank of California
Banque Nationale De Paris
Liu Chong Hing Bank Limited
Wells Fargo Bank
Silicon Valley Bank
Metrobank

COLORADO

Coergon, Inc.
CoBank
Colorado National Bank
First Interstate Bank of Denver

CONNECTICUT

Centerbank
Union Trust Company

DISTRICT OF COLUMBIA

Abu Dhabi International Bank Inc.
Riggs National Bank
U.S. Department of the Treasury

FLORIDA

ABN Amro Bank, N.V.
American Express Bank Int'l, Miami Branch
AmTrade International Bank of Florida
Banco Popular del Ecuador, S.A, Miami Agency
Banco Santander International

Banque Sudameris
Barnett Bank
Credit Suisse
First Union National Bank of Florida
Hamilton Bank, N.A.
IBJ Schroder International Bank
Jamaica Citizens Bank Ltd.
Lloyds Bank Plc Miami
NationsBank International Miami
Northern Trust Bank of Florida, N.A.
Popular Bank of Florida
Salomon Brothers Inc.

GEORGIA

ABN Amro Bank, N.V.
Bank South, N.A.
NationsBank of Georgia N.A.
Standard Chartered Bank
Summit National Bank
SunTrust Bank, Inc.
Trust Company Bank

HAWAII

Bank of Hawaii
First Hawaiian Bank

IOWA

Brenton Bank & Trust Company of Cedar Rapids
Firstar Bank Cedar Rapids, N.A.
Bankers Trust Company

ILLINOIS

ABN Amro Bank (Chicago Branch)
American National Bank & Trust of Chicago
Bank of America, Illinois

Caisse Nationale de Credit Agricole
Chicago-Tokyo Bank, The
Continental Bank N.A.
First National Bank of Chicago
Harris Trust & Savings Bank
LaSalle National Bank
Northern Trust Bank, The
Old Kent Bank

INDIANA

Fort Wayne National Bank
Bank One, Indianapolis, N.A.
NBD Bank, N.A.

KANSAS

U.S. Central Credit Union, Overland Park

KENTUCKY

Liberty National Bank & Trust Company

LOUISIANA

Hibernia National Bank
Premier Bank, N.A.

MARYLAND

First National Bank of Maryland
Maryland National Bank
Signet Bank

MASSACHUSETTS

ABN Amro Bank, N.V.
Bank of Boston
Fleet Bank of Massachusetts
Shawmut Bank N.A.

State Street Bank & Trust Company
Boston Safe Deposit & Trust Company
BayBank Boston, N.A.

MICHIGAN

Comerica Bank
First of America Bank
Michigan National Bank
NBD Bank
Old Kent Bank

MINNESOTA

First Bank System
National City Bank of Minneapolis
Norwest Bank Minnesota N.A.

MISSOURI

Commerce Bank of Kansas City N.A.
Mercantile Bank of St. Louis N.A.
Boatmen's National Bank of St. Louis

NEBRASKA

National Bank of Commerce Trust & Savings Assoc.
First National Bank of Omaha
Firstier Bank, N.A.

NEW JERSEY

Morgan Laboratories, Inc.
Midlantic National Bank
United Jersey Bank
Bank of Tokyo Ltd.
McDonnell Douglas Information Systems, Inc.
First Fidelity Bank N.A.
Painewebber, Incorporated

NEW YORK

Key Bank of New York N.A.
Chase Manhattan Bank N.A.
ABN Amro Bank, N.V.
Allied Irish Bank
American Express Bank Ltd.
American Management Systems, Inc.
American Scandinavian Banking Corp.
Arab American Bank
Arab Bank PLC
Arab Banking Corporation
Aslk-Cger Bank
Atlantic Bank of New York
Australia & New Zealand Banking Group Ltd.
Banca Commerciale Italiana
Banca Di Roma
Banca Nazionale Del Lavoro
Banca Nazionale dell'Agricoltura
Banca Serfin, S.A.
Banco Atlantico
Banco Bamerindus do Brasil
Banco Bilbao Vizcaya S.A.
Banco Bradesco S.A.
Banco Central Hipanoamericano S.A.
Banco De Credito Del Peru
Banco de Galicia Y Buenos Aires, N.Y. Branch
Banco De La Nacion Argentina
Banco De La Provincia De Buenos Aires
Banco De La Republica Oriental Del Uruguay
Banco Di Napoli
Banco Do Brasil, S.A.
Banco do Estado de Sao Paulo S.A.
Banco Industrial De Venezuela, N.Y. Agency
Banco International, S.A.
Banco Nacional de Mexico S.A.
Banco Nacional S.A.

Banco Portuguea Do Atlantico
Banco Real S.A.
Banco Santander, New York Branch
Bancomer, S.A.
Banesto Banking Corporation
Bangkok Bank Public Company Ltd., New York
Bangkok Metropolitan Bank, Ltd.,
Bank Audi (USA)
Bank Austria Aktiengesellschaft
Bank Brussels Lambert
Bank Bumi Daya, New York Agency
Bank Hapoalim B.M.
Bank Julius Baer & Co. Ltd.
Bank Leumi Trust Company
Bank of Bermuda Ltd. N.Y.
Bank of California International, The
Bank of China, New York Branch
Bank of Communications, New York Branch
Bank of East Asia, Ltd., The
Bank of Hawaii International Corporation
Bank of Ireland
Bank of Montreal
Bank of New York
Bank of Nova Scotia
Bank of Yokohama, Ltd., The
Bank Polska Kasa Opieki
Bank Rakyat Indonesia
Bank Saderat Iran
BankAmerica International
Bankers Trust Company
Banque Francaise Du Commerce Exterieur
Banque Indosuez
Banque Nationale De Paris
Banque Paribas
Banque Worms Capital Corp.
Barclays Bank PLC
Bayerische Hypotheken-Und Wechsel-Bank

Bayerische Landesbank Girozentrale
Bayerische Vereinsbank A.G.
Berliner Handels-Und Frankfurter Bank
BPD International Bank
Brown Brothers Harriman & Company
BSI-Banca della Svizzera Italiana
Caisse Nationale de Credit Agricole
Canadian Imperial Bank of Commerce
Cariplo Spa
Chemical Bank
Chiba Bank, Ltd.
Cho Hung Bank
Christiania Bank
Citibank N.A.
Commercial Bank of Kuwait
Commercial Bank of New York
Commerzbank A.G. New York Branch
Commonwealth Bank of Australia
Compagnie Financiere de CIC et de l'Union Europeen
Continental Bank International
Credit Commercial De France
Credit Lyonnais
Credit Suisse
Creditanstalt-Bankverein
Credito Italiano
Dai-ichi Kangyo Bank, Ltd., The
Daiwa Bank Trust Company
DBS Bank
Den Danske Bank
Deutsche Bank AG
DG Bank (Deutsche Genossenschaftsbank)
Dresdner Bank A.G.
Extebank
Federal Reserve Bank of New York
First Bank of the Americas
First Chicago International, New York Branch
French American Banking Corp.

Fuji Bank Ltd.
Generale Bank
Girocredit Bank
Goldman Sachs Trust Company
Gulf International Bank, New York
Harris Bank International Corporation
IBJ Schroder Bank & Trust Company
Industrial Bank of Japan, Ltd.
ING (US) Capital Holdings Corp.
International Commercial Bank of China, The
International Finance Banking Corporation
Israel Discount Bank of New York
Istituto Bancario San Paolo Di Torino Spa
Kansallis-Osaka-Pankki (New York Branch)
Kapiti, Inc.
Korea Exchange Bank, New York Branch
Kredietbank, N.Y. Branch
Landesbank Hessen-Thueringen
LBS Bank-New York
Lloyds Bank Plc
Long-Term Credit Bank of Japan, Ltd.
Manufacturers And Traders Trust Company
Marine Midland Bank
MeesPierson
Merchants Bank of New York, The
Merrill Lynch International Bank
Mitsubishi Bank Ltd., The
Mitsubishi Trust & Banking Corporation
Mitsui Trust & Banking Company, Ltd.
Monte del Paschi di Siena
Morgan Guaranty Trust Company of N.Y.
MTB Bank
Multibanco Comermex S.A
National Australia Bank Ltd.
National Bank of Canada
National Bank of Kuwait
National Westminster Bank PLC

NationsBank International
NatWest Bank, N.A.
Nippon Credit Bank, Ltd
Norddeutsche Landesbank Girozentrale
Northern Trust Int'l Banking Corp., The
Norwest Bank International
Park Avenue Bank, N.A., The
Philadelphia International Bank
PNC Bank International, New York
Postipankki Ltd.
PT. Bank Dagang Negara (Persero) N.Y. Agency
Rabobank Nederland
Republic National Bank of New York
Royal Bank of Canada
Royal Bank of Scotland Plc
Sakura Bank Limited
Sanwa Bank Ltd. New York
Siam Commercial Bank, Ltd.
Skandinaviska Enskilda Banken
Societe Generale
Standard Chartered Bank Ltd.
State Bank of India
State Street Bank International
Sterling National Bank & Trust Company
Sumitomo Bank Ltd., The
Sumitomo Trust & Banking Co., Ltd
Svenska Handelsbanken
Swedbank
Swiss Bank Corporation
Thai Farmers Bank Public Co., Ltd.
Tokai Bank Ltd.
Toronto-Dominion Bank, The
Unibanco-Uniao De Bancos Brasileiros S.A.
Unibank A/S
Union Bank of Finland Ltd.
Union Bank of Switzerland
United Bank of Kuwait Plc., The

United Overseas Bank, Ltd.
Westdeutsche Landesbank
Westpac Banking Corporation
Yasuda Trust & Banking Co., Ltd., The
Nordbanken New York Branch
European American Bank

NORTH CAROLINA

First Union National Bank of North Carolina
NationsBank of North Carolina, N.A.
Southern National Bank
First Citizens Bank
Wachovia Bank

OHIO

Fifth Third Bank, The
Provident Bank, The
Star Bank, N.A.
National City Bank, Cleveland
Society National Bank
Bank One, Columbus, N.A.
Huntington National Bank, The

OKLAHOMA

Bank of Oklahoma, N.A.
Liberty Bank & Trust Company of Tulsa, N.A.

OREGON

First Interstate Bank of Oregon, N.A.
U.S. National Bank of Oregon

PENNSYLVANIA

Dauphin Deposit Bank & Trust Company
CoreStates Bank N.A.

Meridian Bank
ABN Amro Bank, N.V. Pittsburgh Branch
Integra Bank
Mellon Bank
PNC Bank, National Association

TENNESSEE

First Tennessee Bank, N.A.
National Bank of Commerce
Union Planters Bank
First American National Bank

TEXAS

Bank One, Texas, N.A., Dallas
NationsBank Texas, N.A.
State National Bank
Sunwest Bank
Bank One Texas N.A., Fort Worth
ABN Amro Bank, N.V. Houston Agency
Bank One, Texas, N.A., Houston
First Interstate Bank of Texas, N.A.
Philidelphia International Bank—Houston Branch
Riyad Bank—Houston Agency
Texas Commerce Bank
International Bank of Commerce
Frost National Bank

UTAH

First Security Bank of Utah N.A.

VIRGINIA

Central Fidelity National Bank
Crestar Bank

WASHINGTON

ABN Amro Bank, N.V.
Christiania Bank
First Interstate Bank of Washington, N.A.
Seattle First National Bank
U.S. Bank of Washington, N.A.
West One Bank
Key Bank of Washington
North Pacific Bank

WISCONSIN

Bank One, Milwaukee, N.A.
Firstar Bank—Milwaukee
M&I Marshall & Ilsley Bank

Supreme Court, U.S.
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No. 95-909

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,
Petitioner,
v.
COMMITTEE OF CREDITORS
HOLDING UNSECURED CLAIMS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Did the Ninth Circuit (following an opinion of the Fourth Circuit) correctly hold that a debtor's preferential payment to a creditor is voidable under Bankruptcy Code Section 547(b) where the creditor received more than it would have under a Chapter 7 distribution?

2. In rendering its opinion, did the Ninth Circuit (as had the Fourth Circuit) properly refuse to consider whether the creditor could benefit from a preferential payment merely because, absent the preference, the creditor would have received payment from a third party?

RULE 29 STATEMENT

Respondent Committee of Creditors Holding Unsecured Claims has no parent company, subsidiaries or affiliates that have issued shares to the public.

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No. 95-909

In the Supreme Court

OF THE

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OCTOBER TERM, 1995

KOCH OIL COMPANY,
Petitioner,
v.
COMMITTEE OF CREDITORS
HOLDING UNSECURED CLAIMS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent Committee of Creditors Holding Unsecured Claims ("Committee") respectfully submits this opposition to Petitioner Koch Oil Company's ("Koch") Petition for Writ of Certiorari.

COUNTERSTATEMENT OF THE CASE

A. Prefatory Statement

In this matter, the Ninth Circuit, demonstrating absolute consistency among the federal courts which have considered the issue, held that a debtor's payment of $3,209,425.81 to Koch less than ninety days before the debtor's bankruptcy filing might be a voidable preference under Section 547(b) of the Bankruptcy Code.[1] Consistent with both statutory language and prior case law, the Ninth Circuit held that, in determining whether a creditor received more from an allegedly preferential payment than that creditor would have received under a Chapter 7 distribution, a court does not consider the creditor's ability to recover payments from a third party. Essentially, the Ninth Circuit's decision reaffirms the unremarkable principle that a creditor should not receive through preferential payments more than it would have received from a Chapter 7 distribution.

Given the clear language of Section 547(b) and the absence of any conflict in the law, this case does not warrant review by this Court. Nonetheless, Koch maintains that, instead of examining whether the allegedly voidable preference resulted in it receiving *more* than it would have received under a Chapter 7 distribution, the correct analysis should be whether the alleged preference resulted in other creditors actually receiving *less* under a Chapter 7 distribution. Koch cites no valid authority for its novel position, and certainly cannot raise an issue meriting this Court's review. Quite simply, the plain language of section 547(b)(5) voids transfers when the creditor received more from the transfer than it would have received under a Chapter 7 distribution.

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[1] The Ninth Circuit remanded the matter to the bankruptcy court to determine what portion, if any, of the $3,209,425.81 is protected from avoidance by Section 547(c)(1) of the Bankruptcy Code. All references to the Bankruptcy Code are to Title 11 of the U.S. Code.

Koch also asserts that the Ninth Circuit's interpretation of Section 547(b) poses a threat to the commercial use of letters of credit. Not only is this assertion completely speculative, but a leading scholar on letters of credit anticipated the Ninth Circuit's decision a number of years ago, offering language for incorporation into letters of credit which would protect parties like Koch.[2] Koch's attempt to create a crisis cannot transform this case into one meriting this Court's review.

B. Statement of Facts

In the early 1980s, the debtor, Powerine Oil Company ("Powerine"), engaged in oil refining. In the course of that business, Powerine entered into a series of note agreements with a number of insurance companies, which collectively loaned Powerine $21,000,000. Later, several banks agreed to lend Powerine up to $229,600,000. As an inducement to the banks to make their loans and to the insurance companies (collectively with the banks, the "Secured Lenders") to waive certain restrictions in their note agreements, Powerine entered into a security agreement with a trustee for the Secured Lenders, whereby Powerine assigned to the trustee a blanket lien in Powerine's assets, including all accounts, equipment, fixtures, inventory, and general intangibles, which in turn included Powerine's bank accounts.

From 1982 until it filed for bankruptcy protection on March 26, 1984, Powerine entered into contracts to buy crude oil from Koch. Powerine's obligations to Koch were buttressed by two letters of credit in favor of Koch. Within ninety days before Powerine filed for bankruptcy, the preference period, Koch billed Powerine three times, for deliveries in December 1983, January 1984, and February 1984.

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[2]The very same literature, albeit a different section of that literature, is cited in both the petition and the amicus brief.

Powerine paid Koch $8,550,900.70 for the deliveries in December and January. However, Powerine failed to pay Koch for the February deliveries, and Koch drew on the letters of credit.

As of the date of its bankruptcy filing, Powerine owed its Secured Lenders approximately $282,000,000, including contingent liabilities for letters of credit that had been issued on its behalf. At that time Powerine's assets were worth approximately $66,000,000. Of the $8,550,900.70 paid to Koch during the preference period, $3,209,425.81 was paid more than 45 days after the oil was actually delivered to Powerine. Following confirmation of Powerine's plan of reorganization, the Committee commenced this action against Koch, challenging the preference period payments as voidable transfers under the Bankruptcy Code.[3]

In September 1989, the Bankruptcy Court for the Central District of California ("Bankruptcy Court") heard cross-motions for summary judgment in this action. The Bankruptcy Court granted Koch's cross-motion for summary judgment, finding that 11 U.S.C. Section 547(c)(1) protected the transfers to Koch from avoidance under the Bankruptcy Code. The Committee properly appealed that judgment to the Bankruptcy Appellate Panel for the Ninth Circuit ("BAP"). In July, 1992, the BAP affirmed the judgment of the Bankruptcy Court, although it did not affirm it under 11 U.S.C. Section 547(c), but rather under 11 U.S.C. Section 547(b)(5). The Committee timely appealed that BAP's order to the Ninth Circuit.

The Ninth Circuit determined that the $3,209,425.81 paid to Koch more than 45 days after the oil was delivered

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[3]Under the plan, the Committee was designated the representative of the estate to pursue the claim. The amended plan provides that any recovery on the claim will be divided between the Secured Lenders and the unsecured creditors of the Powerine estate.

was preferential under Section 547(b) of the Bankruptcy Code. The Ninth Circuit concluded, however, that Bankruptcy Code Section 547(c)(1) might shield some of that payment from avoidance to the extent that a corresponding contingent secured claim against Powerine was also released. The Ninth Circuit remanded the matter to the Bankruptcy Court for determination of that issue.

REASONS FOR DENYING KOCH'S PETITION FOR WRIT OF CERTIORARI

I.

The Bankruptcy Code's preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. *Union Bank v. Wolas*, 502 U.S. 151, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991). Any creditor that receives a greater payment than others of its class is forced to disgorge so that all may share equally. *Id.* at p. 157. Section 547(b) empowers the trustee to restore equal status to all creditors by voiding any transfer by the debtor to a creditor made during the preference period that results in that creditor receiving more than it would under a hypothetical Chapter 7 distribution of the debtor's estate. *Id.* at p. 151; *Alvarado v. Walsh (In re LCO Enterprises)*, 12 F.3d 938 (9th Cir. 1993).[4] Put differently, Section 547(b) requires an inquiry into whether a creditor receives a greater percentage of its claims than it would have

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[4]Section 547(b), which contains provisions sometimes referred to as the "greater amount" test, requires the court to construct a hypothetical Chapter 7 case and determine what the creditor would have received if the case had proceeded under Chapter 7. *In re Ehring*, 900 F.2d 184, 188 (9th Cir. 1990); *In re Lewis W. Shurtleb*, 778 F.2d 1416, 1420-22 (9th Cir. 1986).

received in its "distributive share" from a Chapter 7 liquidation.[5]

Applying the plain language of Section 547(b), the Ninth Circuit held that Powerine's payment to Koch during the preference period was voidable because Koch unquestionably received more of the $3,209,425.81 than it would have received under a Chapter 7 distribution.[6]

The Ninth Circuit did not apply the test that Koch presses here, namely that in calculating what a creditor would have received under a Chapter 7 distribution, a court should consider the creditor's ability to obtain payments from third parties absent the preferential payments. In this regard, the Court of Appeals' decision is consistent with *In re Virginia-Carolina Financial Corp.*, 954 F.2d 193 (4th Cir. 1992), where a Chapter 7 trustee sued a creditor on the

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[5]The House Report on Section 547(b) states:

> "The transfer must enable the creditor to or for whose benefit it was made to receive a greater percentage of his claim than he would receive under the distributive provisions of the bankruptcy code. Specifically, the creditor must receive more than he would if the case were a liquidation case, if the transfer had not been made, and if the creditor received payment of the debt to the extent provided by the provisions of the code."

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977) at p. 372. Commentators on this Report make clear that this test is what the creditor would receive under the "distributive provisions" of the Bankruptcy Code. Herzog and King, *Collier Pamphlet Edition Bankruptcy Code Part 1*, p. 442 (Matthew Bender 1993).

[6]In fact, as an unsecured creditor, Koch would have received nothing in a Chapter 7 distribution, since there was a general lien in favor of the Secured Lenders, whose claims far exceeded the value of all Powerine's assets. *See Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750 (11th Cir. 1983).

ground that a payment on a loan made before the bankruptcy was a voidable preference. The Fourth Circuit held:

> "As the plain language of Section 547(b)(5) conveys, the court must focus, not on whether a creditor may have recovered all the monies owed by the debtor from any source whatsoever but instead upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation."

Id. at p. 199 (citing Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 735-37 (1985)): *Accord, In re Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bankr. E.D. Mich. 1984) (stating, in relevant part, that the only relationship that is crucial to a preference section is the creditor's relationship to the debtor). This reasoning is also consistent with the recent decision of the bankruptcy court in *Krafsur v. Scurlock Permian Corp. (In Re El Paso Refinery, Ltd. Partnership)*, 178 B.R. 426 (Bankr. W.D. Tex. 1995).[7] That case, like this case, involves alleged preferential payments to an oil company, who was also the beneficiary under certain letters of credit. *Id.* at pp. 430-431. In applying the test of Section 547(b)(5), and concluding that a portion of the alleged preferential transfer was voidable, the court expressly noted that:

> "A trustee need only prove that, as a result of the transfer, the creditor received a greater percentage recovery on its debt than it would otherwise have received had it looked *solely to distribution from the Chapter 7 estate for its payment.*"

Id. at p. 433 (Emphasis supplied).

In re Virginia-Carolina Financial Corp., *In re Formed Tubes* and *In re El Paso Refinery, Ltd. Partnership* are the

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[7] Currently on appeal to the United States District Court for the Western District of Texas.

only other cases the Committee is aware of which address this issue. So, the Ninth Circuit's decision follows the letter of the statute and is in complete accord with the only other courts considering similar issues. For that reason, Koch's petition should be denied.

II.

In seeking to justify review, Koch makes two additional arguments, neither of which support its request for review. Koch first asserts that, in conducting an analysis under Section 547(b), "a court must determine whether the transfer alleged to be preferential reduced the amount an unsecured creditor would have received by a hypothetical Chapter 7 liquidation under a hypothetical alternative set of facts." (Petition, at p. 12.) In other words, according to Koch, if, absent the preference, the other creditors would have received the same amount, then the preference is not voidable. In support of this argument, Koch cites *Continental & Commercial Trust & Savings Bank v. Chicago Title & Trust Co.*, 229 U.S. 435, 444, 33 S.Ct. 829, 57 L.Ed. 1268 (1913); *New York County National Bank v. Massey*, 192 U.S. 138, 147, 24 S.Ct. 199, 48 L.Ed. 380 (1904); and *Virginia National Bank v. Woodson*, 329 F.2d 836, 840 (4th Cir. 1964). Koch's contention is unsupportable.

Significantly, *Continental, Massey* and *Woodson* do not address Section 547 at all. Instead, these cases concern the so-called "diminution of the estate" doctrine of the prior Bankruptcy Act of 1898. That doctrine supposedly requires a court in a preference action to examine what other unsecured creditors of Powerine would receive under a Chapter 7 distribution. But, putting aside the inapplicability of that doctrine to current law, not even the Bankruptcy Act of 1898 contained any explicit "diminution of the estate" doctrine. *See Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750,

755 (11th Cir. 1983). The cases on which Koch relies do not support Koch's assertions here.

In *Continental and Commercial Trust and Savings Bank v. Chicago Title and Trust, supra,* decided under the prior Bankruptcy Act, a debtor who was a member of the Chicago Board of Trade had held certain margin certificates representing the security deposits that he had made with other traders. During the preference period, the debtor relinquished any claim to the certificates as part of an arrangement to satisfy various debtors. When the trustee attempted to avoid the transfer of the certificates as a preference, this Court found:

> "What was done did not in fact diminish the estate of Prince [the debtor], otherwise available to the creditors in the bankruptcy proceeding, for the traders holding them would have had the benefit of the deposits under the terms of the certificates and the rules of the Board of Trade." 229 U.S. at pp. 443-44.

In other words, "the creditors of the [debtor's] estate had no claim on the margin certificates." *Deel Rent-A-Car,* at p. 756 (discussing the *Continental and Commercial Trust* case at length). That is, since the property transferred was not the property of the debtor's estate, there could be no preference. Here, there clearly was a transfer of Powerine's property to Koch (Powerine paid $3,209,425.81 to Koch).

In *New York County National Bank v. Massey, supra,* this Court, again under the prior Bankruptcy Act, reconciled preference law with a bank's "right of set-off recognized and enforced in law" over a bank deposit, stating:

> "one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit . . ." *Id.* at p. 147.

Since this Court found that a deposit was "not a transfer of property as a payment, mortgage, gift or security," the deposit could not be a preference. *Id.* Again, here, Powerine clearly transferred money to Koch.

In *Virginia National Bank v. Woodson*, the debtor's sister paid $8,000 within the preference period to a creditor of the debtor. The *Woodson* court held that the payment could not be a voidable preference, since the payment had not been property of the debtor's estate and thus could not have diminished the bankruptcy estate. *Id.* at p. 839. However, the *Woodson* court also found that the transfer of certain rights to a swimming pool, which had been transferred from the debtor to his sister as part of the payment to the creditor, could be a voidable preference. *Id.* In stark contrast to this case, *Woodson* — like the other cases on which Koch relies — involved no transfer of the debtor property to the creditor.

Koch's interpretation of Section 547 would stand Section 547(b)(5) on its head. Instead of focusing on what Koch would have received under a Chapter 7 distribution, Koch would inquire into what Powerine's other unsecured creditors would receive under a Chapter 7 distribution, irrespective of whether Koch received a preference. Such an approach is justified neither by the statutory language nor the case law.

III.

Finally, Koch and Amicus Curiae assert that the Ninth Circuit's decision "will mark the end of the usefulness of the standby letter of credit." Koch claims that "prior to the ruling of the Court of Appeals in this case, standby letters of credit gave creditors confidence that they would receive a nonpreferential payment, even from an insolvent debtor." (Petition, at p. 20). Koch asserts, without authority, that

such creditors will now lose confidence in letters of credit. The argument is without merit.

First, as an empirical matter, Koch has nowhere presented facts to support its assertion. Second, the argument that the Ninth Circuit's opinion somehow frustrated commercial expectations lacks merit. As early as 1991, a leading commentator on letters of credit noted that an insolvent debtor's payment to a beneficiary under a letter of credit could be a preference. *See*, *Dolan*, The Law of Letters of Credit, ¶ 7.03(3)(e) (2d Ed. 1991). Dolan even suggested a drafting alternative that would avoid such a result. *Id.*[8] Thus, contrary to Koch's dire prediction, the Ninth Circuit's opinion was anticipated in the literature, and any hypothetical issues arising from the opinion can be — and indeed, given the dearth of reported case law, may have been in many cases alleviated by simple drafting.[9]

Disregarding that drafting option, the Amicus Curiae asserts that the Ninth Circuit's decision "upsets the reasonable expectations of letter of credit beneficiaries" (Brief of Amicus Curiae, at p. 11) and "creates an unwarranted exception to the 'independence' principle provided in domestic and international letters of credit" (*Id.* at p. 3.) In

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[8]Specifically, Dolan stated:

> "If the account party pays the note, there will be no draw on the credit, which may expire by its terms. If the account party becomes bankrupt, and if the payment occurs during the preference period, the trustee may be able to set the payment aside. At that point, the beneficiary will have to surrender the payment it received and will not be able to draw on the expired credit. A beneficiary that doubts the account party's solvency will insist that the credit not expire for a sufficient period of time after payment and that it be payable against documents certifying the existence of bankruptcy proceedings."

[9]Undoubtedly the market has already internalized the cost of such revisions to the terms of these types of letters of credit.

support of this assertion, the Amicus Curiae cite *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813 (2d Cir. 1992); *American Bank & Leasing Service Co. (In Re Air Conditioning)*, 845 F.2d 293 (11th Cir. 1988); and *Kellogg v. Blue Quail Energy, Inc. (In Re Matter of Compton Corp.)*, 831 F.2d 586 (5th Cir. 1987).

The reliance on the "independence" principle and these cases are misplaced. Under the "independence" principle, an issuer's obligation to a letter of credit's beneficiary is independent from any obligation between the beneficiary and the issuer's customer. *Kellogg*, at p. 589. However, that principle has no relevance to this case, since this case did not involve the actual payment under a letter of credit. To the contrary, because Koch received a payment (albeit a preferential payment) from the debtor, no obligation to pay under the letters of credit even arose, and the issuer never had to examine the customer/beneficiary obligation. The letters, like many in commercial law, merely expired by their terms.[10]

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[10]The cases cited by the Amicus Curiae do not support its conclusion. *Alaska Textile Co.* did not even involve a bankruptcy proceeding, but instead concerned the narrow issue of a bank's duties under the Uniform Customs and Practices for Document Credits when a beneficiary under a letter of credit presents documents for payment to the bank "on an approval basis." *Id.* 982 F.2d at p. 814. In *American Bank & Leasing Service Co.*, the court merely affirmed a judgment holding that a payment made pursuant to a letter of credit was a preference, after finding unpersuasive the creditor's "waving a banner acclaiming inviolability of letters of credit" as a defense to Section 547(b). 845 F.2d at 296. *Finally, Kellogg v. Blue Quail Energy* concluded that the transfer at issue was a preference. 831 F.2d at p. 589. Nothing in these cases transforms this case into one meeting the standards for this Court's review.

CONCLUSION

For all the above reasons, Koch's Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AGAINST POWERINE OIL COMPANY, DEBTOR IN BANKRUPTCY,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The brief of Powerine Oil Co.'s unsecured creditors in opposition to certiorari squarely joins the issue on the question presented by the Ninth Circuit's decision in this case, namely, whether the venerable "diminution of the estate" doctrine is to be observed in applying the voidable preference test of the Bankruptcy Code? The respondent creditors maintain that it should not be—that whether or not a pre-bankruptcy transfer of a debtor's assets results in a diminution of the estate available to the creditors of the same class as the transferee makes no difference in determining whether the transfer is voidable under Section 547 of the Code. The creditors dismiss the doctrine as a relic of the Bankruptcy Act of 1898 that is inapplicable under the present Code. Brief in Opposition p. 8.

The respondent creditors acknowledge that they would have received nothing in a Chapter 7 liquidation of Powerine regardless of the transfer to Koch because "there was a general lien in favor of the Secured Lenders, whose claims far exceeded the value of all Powerine's assets." Brief in Opposition p. 6 fn. 6. Their interest in having the transfer to Koch voided springs from a side agreement reached with the secured creditors as part of a reorganization plan under which they would receive a bounty of 50% of any amount recovered from Koch. Brief in Opposition p. 4.

The unsecured creditors downplay the complete novelty of the Ninth Circuit's finding that the transfer to Koch was voidable under these circumstances—portraying the ruling as merely a reaffirmation of an unremarkable principle recognized in prior case law. Upon examination, however, each of the decisions the creditors point to in support of that contention, proves to differ from this case in a critically important respect: each was decided in a factual context where the transfer alleged to be voidable *would have* resulted in a diminution of the estate available to creditors and the opinion in each case reflects an awareness that the "diminution" principle continues to be *the defining characteristic* of a preferential transfer in bankruptcy law.[1] Unlike the Ninth Circuit, these courts

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[1] "[W]e cannot accept the contention that a creditor's security interest in an asset of an entity not in bankruptcy . . . enables the creditor to elect to draw from the bankruptcy estate 100% of the debt owed, *at the expense of the debtor's other creditors.*" [emphasis supplied]. *In re Virginia-Carolina Financial Corp.*, 954 F.2d 193, 198 (4th Cir. 1992). "The focus instead must be on *the effect which the transfer has had upon the debtor's estate.*" [emphasis supplied]. *In re El Paso Refinery, L.P.*, 178

(continued...)

would not have found a voidable preference had the transfer at issue not resulted in a diminution of the estate.

The creditors' assertion that standby letters of credit easily can be adjusted to accommodate the Ninth Circuit's novel holding is not persuasive. No doubt, for a price, standby letters of credit could be written to extend the issuer's obligations beyond the payment of the underlying debt for such period of time as would be necessary to eliminate the possibility that the payment could be voided in a bankruptcy proceeding. But that would require securing the issuer for that period of time, as well. The unique utility of a standby letter of credit lies in its stake holding function, which affords a debtor the option to pay the underlying debt out of the deposits securing the issuing bank. Extending the issuer's exposure on the letter of credit beyond the use of these deposits to pay the underlying debt would defeat the purpose of a standby letter of credit.

The Ninth Circuit's ruling needlessly cabins an instrument of commercial finance that has proven enormously useful to bankers and businesses for many years. This Court should take this opportunity to dispel the notion that Congress intended to abandon the "diminution of

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[1] (...continued)
B.R. 426, 432 (Bankr. W.D. Tex. 1995). "[I]f, in the case now before the court, funds remained to be drawn on the letters of credit that equaled or exceeded the debtor's payment . . . , a finding that the transfer was preferential *would not benefit the estate.*" [emphasis supplied]. *In the Matter of Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bankr. E.D. Mich. 1984) (explaining the relevance of determining the net effect of transfers on the size of the fund available to satisfy the claims of general creditors.)

the estate" doctrine when it enacted the voidable preference provisions of the Bankruptcy Code in favor of the novel dog-in-the-manger interpretation of the preference provisions espoused by the Ninth Circuit in this case.

CONCLUSION

For the reasons stated herein, and in the Petition, this Court should grant the writ and reverse the decision below.

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